88-1482

Supreme Court, U.S.
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MAR 9 1989
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CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

No. ___

THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA, *Petitioner,*

v.

ANR PIPELINE COMPANY, et al., *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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March 9, 1989

80pp

QUESTION PRESENTED

Is the State of Oklahoma pre-empted under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 from exercising regulatory authority over interstate pipelines pursuant to OKLA. STAT. tit. 52 §240?

PARTIES

Petitioner:

The Corporation Commission of the State of Oklahoma

Respondents:

ANR Pipeline Company
Colorado Interstate Gas Company
Columbia Gas Transmission Corp.
KN Energy, Inc.
Mississippi River Transmission Corp.
Natural Gas Pipeline Company of America
Tennessee Gas Pipeline Co.
Williams Natural Gas Co.
El Paso Natural Gas Company
Western Gas Interstate Company
Southern Natural Gas Company

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

THE CORPORATION COMMISSION OF
THE STATE OF OKLAHOMA,

Petitioner,

v. No. _____

ANR PIPELINE COMPANY, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioner Corporation Commission of the State of Oklahoma ("Corporation Commission") respectfully prays that a writ of certiorari issue to review the final judgment and opinion of the United States Court of Appeals for the Tenth Circuit holding that Oklahoma's ratable take statute, OKLA. STAT. tit. 52 §240 and the implementing rule, Rule 1-305 of the Oklahoma Corporation Commission Oil and Gas Rules, are not constitutional as being violative of the Supremacy Clause in Art. VI, cl. 2 of the United States Constitution for the reason that the state statute and administrative rule are preempted by the Natural Gas Act of 1938, U.S.C. §§717-717w (1976), and the Natural Gas Policy Act of 1978, 15 U.S.C. §§3301-3432 (1982).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit, reported at 860 F.2d. 1571 (1988), appears as Appendix A hereto. The opinion of the United States District Court for the Western District of Oklahoma, reported at 643 F.Supp. 419 (1986), appears as Appendix B hereto.

JURISDICTION

This case involves a challenge to the constitutionality of Corporation Commission Rule 1-305 and Oklahoma's ratable take statute, OKLA. STAT. tit. 52 §240. The United States Court of Appeals for the Tenth Circuit entered its judgment on November 9, 1988, declaring the challenged statute and rule unconstitutional. The Notice of Appeal, Appendix C hereto, was filed in the Tenth Circuit Court of Appeals on January 9, 1989. Upon application, this Court granted a thirty (30) day extension of time, or until March 9, 1989, to file this petition for a writ of certiorari. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent provisions are set forth in full in Appendix D hereto.

STATEMENT OF THE CASE

This case arises out of the issuance of Order No. 281285, Appendix E hereto, concerning the assertion of jurisdiction by the Corporation Commission over the prioritization of wellhead takes of Oklahoma-produced natural gas by interstate pipelines.

Beginning in early 1983, the natural gas industry in the State of Oklahoma experienced an unprecedented market demand crisis. This crisis came to the attention of the Corporation Commission when an unusually large number of ratable take applications were filed, indicating that newly drilled wells could not obtain pipeline connections and that connected wells were being shut in. In response, on October 19, 1983, the Corporation Commission duly promulgated Rule 1-305, Appendix F hereto, establishing a priority schedule mandating in which various categories of natural gas are to be purchased when the supply of natural gas exceeds the demand.

Thereafter, producers of natural gas in Oklahoma filed applications with the Corporation Commission requesting, among other things, that certain purchasers of natural gas be ordered to take ratably in accordance with OKLA. STAT. tit. 52 §240 and Corporation Commission Rule 1-305. A common issue raised

in each separate proceeding was whether the Corporation Commission had jurisdiction over interstate pipelines. On January 9, 1984, the Oil and Gas Conservation Division of the Corporation Commission filed a Notice of Inquiry and Motion to Consolidate Causes. On February 27, 1984, the Corporation Commission ordered that the pending proceedings be consolidated for the purpose of hearing arguments as to the jurisdictional question and that all parties interested be invited to participate in a generic proceeding concerning the following two issues:

> (1) Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforcing the requirements of 52 O.S. 1981, §240, relating to the ratable taking of gas, against first purchases by interstate pipelines of Oklahoma-produced natural gas?
>
> (2) Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, §§239 and 240?

The interstate pipelines claimed that the statute and rule imposed economic burdens upon them by increasing their cost of gas and by causing them to incur a take or pay obligation. The pipelines further argued that only the Federal Energy Regulatory Commission (FERC) has the right to decide interstate purchase priorities regardless of state conservation objectives.

However, the Corporation Commission determined that the pipelines had misinterpreted the scope of takes covered by Rule 1-305 and that the Commission had not sought to enforce Rule 1-305 against any pipeline. The above-enumerated jurisdictional issues were considered after extensive briefing and oral arguments. The Corporation Commission ultimately issued Order No. 281285 on July 3, 1985, which contemplated that pending applications would proceed on their individual merits, with consideration of relevant facts particular to each case being presented at an administrative hearing.

The action below was brought by Respondents ANR Pipeline Company, et al., for declaratory and injunctive relief to prohibit the Corporation Commission from assuming jurisdiction and applying Section 240 and Corporation Commission Rule 1-305 against them. In addition, an appeal from Order No. 281285 was timely lodged in the Supreme Court of Oklahoma on August 2, 1985, in Case No. 64890, *Panhandle Eastern Pipe Line Company v. Corporation Commission of Oklahoma*, and is still pending.

Reason for Granting the Writ

This Court should grant the requested writ because this case involves an important federal question concerning the Supremacy Clause. Relying on *Northern Natural Gas Co. v. State Corp. Comm'n. of Kan.*, 372 U.S. 84 (1963) and *Transcontinental Gas Pipe Line Corp v. State Oil and Gas Board*, 474 U.S. 409 (1986), the United States Court of Appeals for the Tenth Circuit (Tenth Circuit) has determined that the Oklahoma Corporation Commission may not exercise regulatory authority over interstate pipeline purchases under provisions of OKLA. STAT. tit. 52 §240 and Rule 1-305 of the Oklahoma Corporation Commission Oil and Gas Rules because such provisions have been pre-empted. Such a conclusion regarding Oklahoma's regulatory scheme is not mandated by previous decisions of this Court. Oklahoma regulation seeks to do no more than protect the public safety, protect vested property interests and prevent the waste of its natural resources and it does so in a manner which clearly furthers the national goal of assuring adequate supplies of natural gas. In failing to recognize the critical role that purchasers play in conservation regulation, the Tenth Circuit's decision will seriously impede the achievement of Oklahoma's conservation objectives. This is a matter which this Court should address for the protection of Oklahoma's important conservation regulation.

1. Federal Pre-emption.

This Court has indicated that state law may be pre-empted in various ways. If Congress explicitly or implicitly evidences an intent to occupy a given field, any state law falling within that field is pre-empted. See *Shaw v. Delta Airlines, Inc.*, 463

U.S. 85, 95-96 (1983); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230; *Schneidewind v. ANR Pipeline Co.*, 485 U.S. ____ (1988). If Congress has not entirely displaced state regulation over the matter in question, state law is still pre-empted to the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law, *Florida Lime and Avocado Growers, Inc. v. Paul*, 323 U.S. 132, 142-143 (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Comm'n.*, 461 U.S. 190 (1983). In determining whether a state law is pre-empted by federal law, one must "start with the presumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress". *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), quoting Rice, supra, at 230.

The federal acts at issue recognize the state's interest in regulating production and lack any prohibition against state regulation of production through regulation of take practices. Furthermore, the state regulation in question neither conflicts with federal law nor stands as an obstacle to the accomplishment of its purpose and objectives.

2. Federal Regulatory Scheme.

The Natural Gas Policy Act (NGPA) was enacted by Congress in 1978 in order to address the problem of gas shortages on the interstate market said to have developed as a result of the pricing scheme under the Natural Gas Act (NGA). See S. Rep. No. 95-436, p. 50 (1977). This Court has determined that "the NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand." *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 421 (1986), ("Transco"). This Court recognized that the Congressional objective in enacting the NGPA was to "give market forces a more significant role in determining the supply, demand, and price of natural gas." *Transco*, 474 U.S. at 422. The

dissent in *Transco* agreed that the "purpose was to decontrol the wellhead price of natural gas sold to interstate pipelines, allowing prices to rise according to market conditions and causing shortages to vanish." *Transco*, 474 U.S. at 431. While Congress chose the principles of the free market as the means of addresing the gas supply problem, the ultimate aim was to assure adequate supplies of gas. *Id.* at 421. Under the NGPA, it is clear that the focus of consumer protection changed from that of protection from high prices to that of "maintaining supplies adequate to meet consumer needs." Note, Legislative History of the Natural Gas Policy Act: Title I, 59 Tex. L. Rev. 101, 116 (1980).

An analysis of the federal regulatory scheme reveals that the field of production regulation has not been occupied by federal law. The legislative history of both the NGA and the NGPA demonstrate clearly that there was no Congressional intent to pre-empt state efforts to conserve its natural resources by preventing waste and protecting correlative rights. H. R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937) (Report of the House Committee on Interstate and Foreign Commerce on H. R. 6586); 124 Cong. Rec. 38, 366 (1978) (Statement of Rep. John Dingell). The decision of this Court in *Transco* does not appear to have precluded a state regulatory scheme such as Oklahoma's which seeks to protect the public safety, protect vested property rights, prevent waste of natural resources by insuring the maximum recovery of its natural gas reserves and further a national regulatory policy of assuring adequate supplies of gas.

3. State Regulatory Scheme.

In 1915, the Oklahoma Legislature enacted legislation the title of which stated "An act to conserve natural gas in the State of Oklahoma, to prevent waste thereof, providing for the equitable taking and purchase of same, conferring authority on the Corporation Commission, prescribing a penalty for violation of this Act, repealing certain Acts, and declaring an emergency". The Act consists of twelve sections now codified as OKLA. STAT. tit. 52 §§236 through 247. For purposes of this case, the main sections are §§239 and 240. On one hand, Section

239 addresses the taking of natural gas, referring to the incidents of production resulting in the withdrawal of gas from a production facility. It mandates ratable production requirements for wells in a common source of supply to protect the correlative rights of owners in the common pool and prevent physical waste. On the other hand, 52 O.S. §240 implements a complementary system requiring a common purchaser, i.e. person in the business of buying and selling gas, to provide nondiscriminatory access to wells within a reasonable distance from its pipeline and to purchase gas ratably when unable to buy all the gas offered. In enacting such a comprehensive coordinated scheme for the conservation of natural gas in Oklahoma, it is clear that the Legislature recognized that in a continuously producing field, achievement of the goal of providing each owner his fair share of the reservoir required by the judicially conceived, statutorily imposed doctrine of correlative rights, and preventing the waste of natural gas, necessitated cooperation of the pipelines.

In an effort to prevent the waste of its natural gas and to protect correlative rights the Corporation Commission promulgated Rule 1-305 on October 19, 1983, establishing a priority schedule for takes of natural gas when a supply and demand imbalance is present within a first purchaser's or first taker's system in Oklahoma. Rule 1-305 establishes a four-tiered priority schedule. Priority One includes hardship and distressed wells; Priority Two includes enhanced recovery wells; Priority Three includes wells producing casinghead gas and associated gas; and Priority Four includes allocated, special allocated and unallocated gas wells. When supply exceeds demand and curtailment of production is required, purchases are made ratably within the lowest category, i.e., Priority Four. If supply continues to exceed demand, then ratable curtailment begins in Priority Three and so on.

One of the reasons for the priorities is to insure continued production of the most vulnerable wells for as long as possible. For example, a Priority One distressed well must be allowed to produce at capacity to avert the safety hazards of a blowout. In comparison, a hardship well may suffer reservoir damage by curtailment of production below a specified rate. Associated

gas production in enhanced oil recovery projects is given second priority because of impairment of the efficiency of the injection operation could occur from gas curtailments. Priority Three gas wells, while not dangerous or vulnerable, are deemed important because these wells produce gas *and* oil. With respect to conventional wells, gas curtailments could result in the venting or flaring of gas to maintain oil production, loss of recoverable reserves through engineering problems or drainage by offsetting producers, and premature abandonment of marginally economical oil wells. Thus, the priorities seek to protect the public safety, to protect correlative rights of property owners in a common pool and to prevent waste of the state's and the nation's valuable and irreplaceable resources.

Under the coordinated scheme adopted by Oklahoma, production is allocated among the wells within a common source of supply based on an individual purchaser's or taker's system market demand. Section 240 and Rule 1-305 are necessary because only by requiring pipelines to take market prorated production can the vested property rights of producers within a common source of supply be protected. By seeking to protect the rights of all who share the right to produce from a common source of supply, these provisions serve the interest of the prevention of waste of natural gas. As once stated:

> [A] failure to protect or adjust the correlative rights of common owners of a common source of supply of oil or gas may be one of the greatest, if not the greatest, factor contributing to the physical waste of oil and gas.*** Where, by statute or regulatory order, correlative rights are protected, so that each owner in an orderly manner is assured of the opportunity of recovering or receiving his fair share of the oil and gas from the common pool, the race is over and all have a common interest in the most efficient and economic recovery of the maximum volume of oil and gas from the common pool, which is true conservation.

Interstate Oil Compact Commission, *A Study of Conservation of Oil and Gas in the United States,* p. 187 (1964).

Ratable take regulations directly promote the prevention of the waste of natural gas resources. As stated in the treatise,

> [i]f permeability is high in the common source of supply of gas, a few operators may effectively drain much of the field. When sufficient reserves have been established to attract a pipeline into the field, the pipeline purchaser is in a position to take most of the gas from a few favored producers. Further, the law of capture makes it possible for a vertically integrated pipeline company to produce gas from its own selected properties and to drain much of the gas from the field without purchasing any gas from other owners. Either situation is conducive to waste above ground and the owners who are not favored are likely to seek or accept opportunities to market the gas for purposes which constitute a waste of valuable energy. The situation is also conducive to waste below the surface in that development wells will not be properly drilled to achieve the maximum in ultimate recovery. Ratable take and common purchaser orders have the common effect of preventing discrimination in carrying and purchasing gas, but the ultimate purpose is to prevent waste and to protect correlative rights.

Summers, *Oil and Gas*, §75.3 (perm. ed. 1962). See also *Seal v. Corporation Commission*, 725 P.2d 278, 286 (Okl. 1986), N. 8.

In order for Oklahoma to have any hope of effectively protecting the public safety, preventing waste and protecting correlative rights, it must be recognized that the regulation of pipeline purchases is an essential part of production regulation. Short of venting or flaring, a producer may produce no more gas than a purchaser will take. The State of Oklahoma clearly has no interest in regulating the takes or purchases of interstate pipelines for the sake of regulation alone, nor is it seeking to protect its producers at the expense of downstream consumers. Oklahoma's assertion of jurisdiction over pipelines is simply necessary for effective regulation of production. Absent such jurisdiction, the public safety, the protection of property rights in the mineral estate and the prevention

of physical waste will be largely dependent upon the economic choices made by interstate purchasers. Such a result could not have been intended by Congress in the development of the federal regulatory scheme.

The state regulatory scheme will not render compliance with federal law impossible nor impede the accomplishment of federal policy. As previously indicated, the ultimate aim of the NGPA was to assure adequate supplies of gas. Congress determined that the free market would best effect such a goal. The statute and rule in question do nothing but promote that goal.

One of the principal purposes of natural gas regulation in Oklahoma is to prevent the waste of natural gas. Such waste prevention efforts help to insure that maximum amounts of gas are recovered. This is entirely consistent with the purpose of the NGPA. In fact, it appears that practices which lead to waste of natural gas would more likely impede the accomplishment of federal policy.

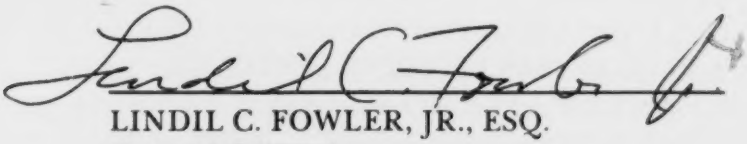
Furthermore, the statute and rule in question do not have the effect of interfering with the operation of the free market principles Congress chose as a means of accomplishing its goal. Free market principles do not operate independently of rules of property or contract and there is no evidence that Congress intended to abolish such rules. Instead, the dissent in *Transco* noted, "markets depend upon such rules to function efficiently". *Transco,* 474 U.S. at 433. Oklahoma's regulatory scheme, in this context, simply defines the property rights of producers within a common source of supply. Such definition and enforcement do not interfere with the federal scheme of wellhead price decontrol. There is nothing in the statute or rule in question that seeks to reimpose price controls. Moreover, while Oklahoma's regulation seeks to maximize the recovery of natural gas reserves, it does not require interstate purchasers to take more gas than their markets demand. Increased costs to these purchasers is not a product of Oklahoma's regulation.

Conclusion

Oklahoma's regulatory scheme seeks to protect the public safety, protect legitimate property interests, and prevent the

waste of its natural resources by ensuring the maximum recovery of its natural gas reserves. It neither invades a field occupied by federal law nor threatens the achievement of the comprehensive scheme of federal regulation. For these reasons, petitioners urge the Court to grant certiorari to correct the lower court's ruling.

Respectfully submitted,



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March 9, 1989

APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

860 F.2d 1571 (10th Cir. 1988)

ANR PIPELINE COMPANY; COLORADO INTERSTATES GAS COMPANY; COLUMBIA GAS TRANSMISSION CORP.; NATURAL GAS PIPELINE COMPANY OF AMERICA; TENNESSEE GAS PIPELINE CO.,

Plaintiffs-Appellees,

WILLIAMS NATURAL GAS COMPANY,

Plaintiff-Appellee,

EL PASO NATURAL GAS COMPANY,

Plaintiff-Intervenor-Appellee,

WESTERN GAS INTERSTATE COMPANY,

Plaintiff,

v. No. 86-2481

THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA,

Defendant-Appellant,

SOUTHERN NATURAL GAS COMPANY,

Defendant-Appellee and Defendant-Intervenor-Appellant,

JAMES B. TOWNSEND, NORMA EAGLETON, and HAMP BAKER, Commissioners of the Corporation Commission of the State of Oklahoma,

Defendants.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA
(NOS. CIV-85-1980-A and CIV-85-1929-A)

S. Paul Hammons (William J. Legg with him on the brief) of Andrews, Davis, Legg, Bixler, Milsten & Murrah, Oklahoma City, Oklahoma, for Plaintiffs-Appellees, ANR Pipeline Company, et al.

Kent L. Jones and Donald L. Kahl of Hall, Estill, Hardwick, Gable, Golden & Nelson, P.C., Tulsa, Oklahoma, on the brief for Plaintiff-Appellee, Williams Natural Gas Company.

R. Thomas Seymour (Caralinn W. Cole, Tulsa, Oklahoma; Donald J. MacIver, Jr., Eldon J. Mitrisin, Barry Schneiderwind, Thomas S. Jensen, El Paso, Texas; James M. Gaitis, Reserve, New Mexico, with him on the brief), Tulsa, Oklahoma, for Plaintiff-Intervenor-Appellee.

Patricia A. Watts (Lindil C. Fowler, Jr., General Counsel, Gretchen P. Hoover Deputy General Counsel, on the briefs), Assistant General Counsel, Oklahoma Corporation Commission, Oklahoma City, Oklahoma, for Defendant-Appellant.

John M. Grower (R. Wilson Montjoy II of Brunini, Grantham, Grower & Hewes, Jackson, Mississippi; John L. Arrington, Jr. and David E. Crawford of Huffman, Arrington, Kihle, Gaberino & Dunn, Tulsa, Oklahoma; and, Joseph H. Moss, Jr. and John C. Griffin of Southern Natural Gas Company, Birmingham, Alabama, with him on the briefs) of Brunini, Grantham, Grower & Hewes, Jackson, Mississippi, for Defendant-Appellee and Defendant-Intervenor-Appellant.

Federick Moring and David H. Soloman of Crowell & Moring, Washington, D.C., filed an Amicus Curiae brief for Associated Gas Distributors.

Hugh D. Rice and Robert J. Campbell, Jr. of Rainey, Ross, Rice & Binns, and Robert D. Stewart, Jr., Oklahoma Gas & Electric

Company, Oklahoma City, Oklahoma, filed an Amicus Curiae brief for Oklahoma Gas & Electric Company.

W. Bland Williamson of Pray, Walker, Jackman, Williamson & Marlar, Tulsa, Oklahoma, The Oklahoma Independent Petroleum Association filed and Amicus Curiae brief for Defendant-Appellant.

Before MOORE, BARRETT, and BRORBY, Circuit Judges.

BRORBY, Circuit Judge.

The plaintiffs in the district court, several interstate natural gas pipelines (Pipelines), are engaged in the business of purchasing, transporting, and reselling natural gas across state lines. They commenced this action against the defendant Corporation Commission of the State of Oklahoma and its individual members, asking for a declaratory judgment holding that federal law pre-empted Oklahoma's ratable take statute and implementing regulation. They also sought injunctive relief, requesting the court restrain the Commission from attempting to implement or enforce the pre-empted statute and regulation. The district court permitted defendant Southern Natural Gas Company, also an interstate pipeline company, to intervene in order to support the constitutionality of the Oklahoma enactments at issue. Both defendants will be referred to jointly as the Commission.

The district court granted the Pipelines' motion for summary judgment, holding Oklahoma's ratable take statute, Okla. Stat. Ann. tit. 52, § 240 (1981), and the implementing rule, Rule 1-305 of the Oklahoma Corporation Commission, to be in contravention of the Supremacy Clause in Art. VI, Cl. 2 of the United States Constitution for the reason that Oklahoma's regulation of interstate pipeline companies interferes with and is pre-empted by the federal regulatory scheme established by the Natural Gas Act, 15 U.S.C. §§ 717-717w (1976), and the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982). The district

court also permanently enjoined the Commission from attempting to implement or enforce the provisions of the statute and rule against the Pipelines or any other interstate pipeline company. The decision of the district court is reported as *ANR Pipeline Co. v. Corporation Comm'n of Okla.*, 643 F. Supp. 419 (W.d. Okl. 1986).

The Commission generally asserts the district court lacked jurisdiction and the pre-emption analysis of the district court was incorrect. For the reasons set forth in this opinion, we AFFIRM the decision of the district court.

I. Background

Oklahoma, in 1915, enacted Okla. Stat. Ann. tit. 52, § 240 (1981)[1] which provided that every person engaged in the business of processing and selling natural gas must purchase all of the natural gas offered for sale from a common reservoir, and if unable to purchase all of such gas, then the common purchaser must purchase natural gas from each seller ratably. This statute also gave to the Oklahoma Corporation Commission the authority

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[1]Section 240 states:

Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all of the natural gas which may be offered for sale, and which may reasonably be reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm, or corporation, shall be unable to purchase all of the gas so offered, then it shall purchase natural gas from each purchaser ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production, or of production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

to make regulations for the equitable purchasing and taking of such natural gas. Oklahoma also enacted Okla. Stat. Ann. tit. 52, § 239 (1981)[2] which provides when full production of natural gas exceeds market demand, the producers of natural gas may take only their proportionate share of the natural flow of the gas. The Commission is given authority to regulate the production of natural gas.

In 1983, the Oklahoma Corporation Commission adopted its Rule 1-305[3] which established a priority schedule mandating

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[2]Section 239 states:

Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm or corporation securing any unfair proportion of the gas therefrom; provided, that the Corporation Commission may by proper order, permit the taking of a greater amount whenever it shall deem such taking reasonable or equitable. The said commission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in favor of any one such common source of supply as against another.

[3]Rule 1-305 states:

(a) Any common purchaser as defined in 52 O.S. 1981, Section 240, shall purchase all the gas which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another, except as authorized by the Commission under (b) below.

(b) In the interest of the prevention of waste and protection of correlative rights the following priority schedule shall be implemented by any first purchaser of gas whenever the permitted production from all wells in any common source of supply in its system in this state, including gas which is processed, is in excess of that purchaser's reasonable market demand; provided, however, if the first purchaser does not contractually control wellhead production, then the first taker of gas shall be responsible for implementation of the following priority schedule.

the order in which various categories of natural gas are to be purchased when the supply of natural gas exceeds the demand.

In 1985, as a result of numerous filings pursuant to § 240

(i) Priority One – Hardship and distressed wells.

(ii) Priority Two – Enhanced recovery wells.

(iii) Priority Three – Wells producing casinghead gas and associated gas.

(iv) Priority Four – If after the first purchaser or first taker has taken the gas from Priorities One through Three above and still has further market demand in its system for gas, said purchaser or taker shall take ratably from all allocated, special allocated and unallocated common sources of supply which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another.

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demand of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratable. All production from the lower priority wells shall be shut-in before production from any well in the next higher priority is curtailed.

(d) Any well which meets the definition of more than one priority shall be assigned the higher priority.

(e) When there is more than one purchaser or taker involved in the taking of gas from a well into any purchaser's system, all purchasers and takers within that system shall be responsible for compliance with this Rule.

(f) Upon a verified application of the Direction of the Oil and Gas Conservation Division, or any other person, the Commission, after notice and hearing, may determine if gas has been ratably purchased or taken from a common source of supply on a systemwide basis in accordance with this rule without avoidable waste and with equitable participation in production and markets by all operators and other interested parties.

(g) In any month wherein a purchaser or taker has a market demand/supply imbalance and must curtail purchases or takes in compliance with this Rule, Form 1004 B shall be filed by said purchaser or taker with the Oil and Gas Conservation Division.

(h) Any interested party may file an application requesting that the Commission, for good cause shown, authorize limited deviation from the general priority schedule provided under (b) above. The Commission on its own motion may initiate a review of the continued need for such a limited deviation. After notice and hearing, the Commission may authorize limited deviation upon finding that the same is necessary in order to prevent waste, protect correlative rights, or is otherwise required by the public interest or authorized by law.

and Rule 1-305, the Commission held several hearings and issued its order No. 281285 wherein it determined the regulation of interstate pipelines to be an incident of the exercise of the Commission's jurisdiction that is necessary to protect correlative rights and prevent waste. The Commission found §§ 239 and 240 of Oklahoma law attempt to adjust production of natural gas to demand in order to protect against drainage. It further held its regulatory jurisdiction does ~~not encr~~oach upon the jurisdiction of the Federal Energy Regulatory Commission (FERC), under either the Natural Gas Act or the Natural Gas Policy Act of 1978, because FERC is not vested with jurisdiction over the production and gathering of gas and concluded "[i]n light of the present regulatory atmosphere" the Commission's jurisdiction can co-exist and complement that of FERC.

II. Subject Matter Jurisdiction

We must first determine whether or not the district court had jurisdiction to decide this controversy. In their complaint, the Pipelines asserted jurisdiction based upon a federal question, 28 U.S.C. § 1331 (Supp. 1988).

The Commission asserts that the district court lacked subject matter jurisdiction because the Pipeline's claim for declaratory judgment fails to raise a federal question. They contend the present controversy fails to raise a federal question. They contend the present controversy falls within the category of cases best illustrated by *Public Serv. Comm'n of Utah v. Wycoff Co.*, 344 U.S. 237 (1952), where the Supreme Court expressed, by way of dicta, that a declaratory judgment plaintiff who asserts the constitutional invalidity of a state action has only a defense that probably does not provide a basis for invoking federal question jurisdiction. *Id.* at 248. Stated differently, the anticipation of a possible defense to state action cannot serve as a basis for federal question jurisdiction.

The cases upon which the Commission relies to assert the district court is without federal question jurisdiction involve an action for declaratory judgment that is not coupled with a request for injunctive relief. *See e.g., Madsen v. Prudential Fed. Sav. & Loan Ass'n,* 635 F.2d 797 (10th Cir. 1980), *cert. denied* 451

U.S. 1018 (1981); *Monks v. Heatherington,* 573 F.2d 1164 (10th Cir. 1978). These cases stem directly from the dicta in *Wycoff.* A helpful discussion of the problems presented by *Wycoff* may be found at 10A C. Wright, A. Miller & K. Kane, *Federal Practice & Procedure* § 2767 (1983 & Pocket Part 1988). We express no opinion concerning the dicta in *Wycoff* and its progeny, because this suit is not based solely on a claim for declaratory judgment but also includes a claim for injunction.

The existence of federal question jurisdiction must appear on the face of the plaintiff's well pleaded complaint. *Phillips Petroleum Co. v. Texaco Inc.,* 415 U.S. 125, 127-28 (1974); *Louisville & Nashville R.R. v. Mottley,* 211 U.S. 149, 152 (1908); 1 J. Moore, J. Lucas, H. Fink, D. Weckstein, & J. Wicker, *Moore's Federal Practice* ¶ 0.62 [2.-2] (1988). The Pipelines' complaint clearly and concisely alleges that plaintiffs are interstate gas pipelines as defined by the Natural Gas Policy Act of 1978, and, as such, are subject to regulation by FERC; that each of the plaintiffs is a "natural gas company" within the meaning of the Natural Gas Act and are therefore regulated by FERC; that the Oklahoma statute and administrative order in question are invalid under the United States Constitution as they conflict with and are pre-empted by federal statutes, the Natural Gas Act and the Natural Gas Policy Act of 1978; and, that plaintiffs seek to enjoin state action, under the statute and rule, which interferes with the interstate pipelines' purchase of natural gas.

Federal courts have jurisdiction over suits to enjoin state officials from interfering with federal rights. In the case of *Shaw v. Delta Airlines, Inc.,* 463 U.S. 85 (1983), the Supreme Court stated:

> It is beyond dispute that federal courts have jurisdiction over suits to enjoin state officials from interfering with federal rights. A plaintiff who seeks injunctive relief from state regulation, on the ground that such regulation is preempted by a federal statute which, by virtue of the Supremacy Clause of the Constitution, must prevail, thus presents a federal question which the federal courts have jurisdiction under 28 U.S.C. § 1331 to resolve. This Court, of course, frequently has resolved preemption disputes in a similar jurisdictional posture.

Id. at 96 n.14 (citations omitted). Adopting the reasoning of *Shaw*, we hold that the district court had federal question jurisdiction under 28 U.S.C. §1331 to enjoin the Commission's enforcement of §240 and Rule 1-305 on the ground that this state law is pre-empted by the Natural Gas Act and the Natural Gas Policy Act. The district court's jurisdiction to resolve the Pipeline's claim for injunction extends to enable the court also to resolve the issues raised by the declaratory judgment action. *Sterling v. Constantin*, 287 U.S. 378, 393-94 (1932).

The Fifth Circuit has decided a case which involves issues and arguments similar to those now before the court, and has reached the same result as we do here. In *Braniff Int'l, Inc. v. Florida Pub. Serv. Comm'n*, 576 F.2d 1100 (5th Cir. 1978), decided prior to and without the benefit of *Shaw*, six air carriers filed suit for declaratory and injunctive relief, challenging the constitutionality of the state statutory scheme regulating the schedules of interstate air carriers as violative of the Supremacy Clause. The court thoroughly analyzed *Wycoff* and its progeny, and held the federal district court could exercise subject matter jurisdiction based upon the existence of a federal question concerning the claims of the airlines. The court specifically held that where a party seeks injunctive and declaratory relief based upon the unconstitutionality of a state statute, and where there are no other concrete impediments to a proper exercise of federal question jurisdiction, the mere fact that constitutional claims might be raised before a state administrative body charged with enforcement of the statute does not alone deprive the court of jurisdiction. *Braniff*, 576 F.2d at 1106.

Our decision affirming the district court's jurisdiction is also supported by many decisions of the Supreme Court which have found federal question jurisdiction where the plaintiff claims pre-emption, and seeks to enjoin enforcement of the state law. *See e.g., Shaw*, 463 U.S. 85; *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977); *Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973); *Sterling*, 287 U.S. at 393; *Ex parte Young*, 209 U.S. 123, 160-62 (1908).

The Pipelines also allege jurisdiction based upon diversity under 28 U.S.C. § 1332. The Commission asserts there is no

monetary amount in controversy. Our holding that jurisdiction exists under 28 U.S.C. § 1331 makes it unnecessary for us to decide this issue, as federal question jurisdiction arising under § 1331 is not dependent upon the amount in controversy. Federal Question Jurisdictional Amendments Act of 1980, Pub. L. 96-486, § 2(a), 94 Stat. 2369.

We therefore conclude the federal district court properly exercised jurisdiction over the Pipelines' claims for injunction and declaratory judgment under 28 U.S.C. § 1331.

III. Actual Controversy

The Commission contends that the action below presents no actual controversy entitling the Pipelines to maintain an action under the Declaratory Judgment Act, 28 U.S.C. §§ 2201, 2202 (1982). It further argues that order No. 281285 only determined the Commission's jurisdiction over interstate pipelines but did not order any action directly affecting the interstate pipelines. The Commission asserts that because it has taken no formalized action directly affecting the interstate pipelines, the Pipelines are merely attempting to secure an advisory opinion.

The Commission relies upon *Wycoff*, 344 U.S. 237, and *Eccles v. Peoples Bank*, 333 U.S. 426 (1948), for the proposition that the district court should not have decided the issues in this action until the Commission entered orders specifically affecting these Pipelines. In both *Wycoff* and *Eccles*, there was no proof that plaintiffs were threatened with regulation. In the instant case, the Commission has issued its regulation and, in an adversarial setting, has ruled that it has jurisdiction to enforce its regulation against these interstate pipeline purchasers. Various producers within the State of Oklahoma have filed their requests asking the Commission to enforce its regulations concerning ratable taking by the interstate pipeline companies. In our view, *Wycoff* and *Eccles* are distinguishable from this case.

Under the Declaratory Judgment Act, a court may declare the rights of a party "in a case of actual controversy." 28 U.S.C. § 2201. In *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1937), the Supreme Court held the required controversy must be definite and concrete, touching the legal relations of the parties having

adverse legal interests, and it must be a real and substantial controversy admitting a specific relief through a conclusive decree, as distinguished from an opinion advising what the law would be upon a hypothetical statement of the facts. This general rule must be applied on a case-by-case basis. Basically, the question in each case is whether the facts alleged, under all the circumstances, show there is a substantial controversy between parties having adverse legal interests of sufficient immediacy and reality to warrant the issuance of a declaratory judgment. *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941).

In the instant case, the Pipelines are attacking the regulation issued by the Commission prior to enforcement. The Pipelines claim Rule 1-305 gives an authoritative interpretation of Okla. Stat. tit. 52, § 240, which will have a direct effect on the day-to day business of all interstate pipeline companies doing business in the State of Oklahoma. The Commission has further ruled, in its order No. 281285, that it has jurisdiction over the interstate gas pipelines to enforce § 240 and Rule 1-305. Section 240 and Rule 1-305 require an immediate and significant change in the Pipelines' conduct of their purchase practices. They will no longer be free to purchase gas from whom they wish, rather they must purchase gas from those persons specified by the State of Oklahoma. If they fail to comply, they may be subject to a $5,000 per day fine. Okla. Stat. tit. 52, § 102. The interstate pipeline companies thus face a dilemma. They must either comply at significant expense, or they may risk penalties.

The case of *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967), presents facts and issues that parallel the instant case. In *Abbott*, the commissioner of food and drugs issued regulations concerning the labeling of drugs. Various drug manufacturers challenged the regulations prior to enforcement. The court of appeals held that no actual case or controversy existed. The Supreme Court held there was an actual case or controversy and stated: "These regulations purport to give an authoritative interpretation of a statutory provision that has a direct effect on the day-to-day business of all prescription drug companies; its promulgation puts petitioners in a dilemma that it was the very purpose of the Declaratory Judgment Act to ameliorate." *Id.* at 152. For a

similar case, *see Gardner v. Toilet Goods Ass'n*, 387 U.S. 167 (1967).

In the case before us, the Commission ruled that it has jurisdiction to require the Pipelines to purchase gas from suppliers other than those with whom the Pipelines have contracts. This will have an immediate and direct effect on the day-to-day business of all interstate pipeline companies doing business in the State of Oklahoma. This ruling also has the real possibility of generating lawsuits between the Pipelines and their existing suppliers, and raises the likelihood of the Pipelines being subject to conflicting directives from both FERC and the State of Oklahoma. The fact that plaintiffs face the threat of irreparable harm from enforcement of the unconstitutional state statute and regulation quite clearly satisfies the "actual controversy' requirement.

According to the evidence presented to the district court at the time of the application for preliminary injunction, the enforcement could adversely increase the Pipelines' "take or pay" liability by many millions of dollars. Parties need not subject themselves to a multiplicity of suits or litigation or await the imposition of penalties under an unconstitutional enactment in order to assert their constitutional claim for an injunction in federal court. *Young*, 209 U.S. at 160. Once the gun has been cocked and aimed and the finger is on the trigger, it is not necessary to wait until the bullet strikes to invoke the Declaratory Judgment Act.

We therefore hold, under the facts of this case, that there is a substantial controversy between parties having adverse legal interests which is of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.

The Commission also asserts the Pipelines lack standing to bring this action because the Pipelines have not suffered an "actual injury." Standing has evolved as a doctrine of constitutional limitation of the federal judicial power found in the "case or controversy" language of Art. III, § 2 of the United States Constitution. Standing may be raised at any time in the judicial process. *Juidice v. Vail*, 430 U.S. 327, 331 (1977); *Citizens Concerned for Separation of Church and State v. City & County of Denver*, 638 F.2d 1289, 1297 (10th Cir. 1980), *cert. denied* 452 U.S. 963 (1981).

Standing problems are currently analyzed by the Supreme Court in two inquiries: (a) whether the plaintiff alleges that the challenged action has caused him injury in fact (economic or otherwise), and (b) whether the interest sought to be protected by the plaintiff is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question. *Association of Data Processing Serv. Orgs. v. Camp*, 397 U.S 150, 152-53 (1970); *Citizens Concerned*, 628 F.2d at 1295.

The Pipelines alleged compliance with § 240 and Rule 1-305 will increase the price of natural gas, impair contractual obligations, and disrupt utilization of pipeline facilities. "Injury in fact" may be shown by out-of-pocket costs to a business resulting from obedience to a new governmental rule. *Hunt v. Washington State Apple Advertising Comm'r*, 432 U.S. 333 (1977); *Mountain States Legal Found. v. Costle*, 630 F.2d 754, 764 (10th Cir. 1980), *cert. denied* 450 U.S. 1050 (1981). The Pipelines also allege they purchase natural gas in Oklahoma, and § 240 applies to purchasers of natural gas. The Pipelines are subject to the comprehensive rules and regulations of the Federal Energy Regulatory Commission acting under the Natural Gas Act and the Natural Gas Policy Act. They assert their obligations under the state rules will conflict with the federal laws. These allegations are sufficient to particularize the injury to these plaintiffs and to indicate their claims come within the zone of interest protected by the Supremacy Clause.

We hold the Pipelines have standing to bring this action.

IV. Abstention

The Commission asserts that even if the district court had jurisdiction, it should have abstained from deciding this case, citing *Buford v. Sun Oil Co.*, 319 U.S. 315 (1943). *Buford* was a diversity suit against the Texas Railroad Commission in which plaintiff sought to enjoin the commission from permitting the drilling and operation of certain oil wells in the East Texas Oil Field. The order under attack involved Texas' regulatory scheme for the conservation of oil and gas within that state. The Supreme Court held the district court erred in exercising federal jurisdiction to review such decisions made by the Texas Railroad Commission.

Burford is clearly distinguishable from the present case. In *Burford,* specialized knowledge pertaining to reservoir technology was required. Here, the Commission has presented no facts which would require specialized knowledge to understand. In *Burford,* the federal court was asked to apply and interpret Texas law. Here, we are applying the law arising under the United States Constitution and Congressional enactments. Moreover, the Pipelines claim Oklahoma lacks jurisdiction to regulate the purchase of natural gas because of federal pre-emption, a claim not raised in *Burford.*

The general law concerning abstention has been enunciated by the Supreme Court. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 14 (1983), the Supreme Court, quoting from *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 813 (1976), stated:

> "Abstention from the exercise of federal jurisdiction is the exception, not the rule. 'The doctrine of abstention, under which a District Court may decline to exercise or postpone the exercise of its jurisdiction, is an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly before it. Abdication of the obligation to decide cases can be justified under this doctrine only in the exceptional circumstances where the order to the parties to repair to the State court would clearly serve an important countervailing interest.'"

Abstention from the exercise of federal jurisdiction is the exception, not the rule, and should not be invoked lightly. In *Colorado River,* the circumstances that are appropriate for abstention have been grouped into three categories: (1) cases presenting a federal constitutional issue that might be mooted or presented in a different posture by state court determination of pertinent state law; (2) cases presenting difficult questions of state law bearing on policy problems of substantial political import whose importance transcends the result in the case then at bar; and, (3) cases where (absent bad faith, harassment or a patently invalid state statute) federal jurisdiction has been invoked for the purpose of restraining state criminal proceedings. *Id.* at 814-16. None

of these circumstances is present in this case.

There is no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of a state policy. *Zablocki v. Redhail*, 434 U.S. 374, 379-80 n.5 (1978). To hold otherwise would mean that a federal court could never declare a state statute unconstitutional. *Wynn v. Carey*, 582 F.2d 1375,1383 (7th Cir. 1978).

We hold the district court was correct in refusing to abstain from exercising jurisdiction.

V. Pre-Emption

Relying on *Northern Natural Gas. Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84 (1963), and *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409 (1986), the federal district court ruled as a matter of law that Okla. Stat. tit. 52, § 240 and Rule 1-305 of the Oklahoma Corporation Commission interfere with and are pre-empted by the federal regulatory scheme established by the Natural Gas Act and the Natural Gas Policy Act. The Commission asserts Oklahoma's regulatory scheme is distinguishable from the regulations of Kansas and Mississippi that were held pre-empted in *Northern* and *Transcontinental*.

The issue to be decided by this court is whether a state statute and regulation requiring an interstate pipeline company to purchase natural gas from all the producers of a natural gas reservoir or field have been pre-empted by federal legislation.

State law can be pre-empted in either of two general ways. In Congress evidences an intent to occupy a given field, any state law falling within that field is pre-empted. If Congress has not entirely displaced state regulation over the matter in question, state law is still pre-empted to the extent it actually conflicts with federal law; that is, when it is impossible to comply with both state and federal law, or where the state law stands as an obstacle to the accomplishment of the full purpose and objectives of Congress. *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1983).

The federal laws which the district court found pre-empted the Oklahoma law and regulation are concisely described in

Transcontinental, 474 U.S. at 420-21:

> Under the [Natural Gas Act], the Federal Power Commission's comprehensive regulatory scheme involved "utility-type ratemaking" control over prices and supplies..." [I]n the early 1970's, it became apparent that the regulatory structure was not working."
>
> * * *
>
> In response, Congress enacted the [Natural Gas Policy Act], which "has been justly described as 'a comprehensive statute to govern future natural gas regulation.'"... The aim of federal regulation remains to assure adequate supplies of natural gas at fair prices, but the [Natural Gas Policy Act] reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. The new federal role is to "overse[e] a national market price regulatory scheme."

(Citations omitted.) The Supreme Court concluded that Congress' determination that the supply, the demand, and the price of high cost gas are to be determined by market forces excluded state regulation of these areas.

Next, we must examine the Oklahoma statute and its attendant regulation. In its most simple form, § 240 requires every purchaser of natural gas to purchase all of the natural gas offered for sale from a common reservoir (without discrimination in favor of one producer as against another, or in favor of one source of supply as against another), and, if the purchaser is unable to do so, then it must purchase natural gas from each producer ratably. Rule 1-305 establishes a priority schedule requiring a purchaser to buy gas from various categories of producing wells in priority order when the supply exceeds the demand.

A reading of § 240 and Rule 1-305 reveals they are intended to and do result in regulation of the purchase of natural gas by interstate pipeline companies. They prevent discrimination in favor of one producer as against another and in favor of one source of supply against another. The Commission's control over the priority of gas purchases interferes with FERC's responsibility in regulating natural gas to allow market forces to

provide an adequate supply at fair prices. The district court found that § 240, and Rule 1-305 allow Oklahoma to skew the free market for natural gas, which is in direct conflict with the federal statutory policy of allowing the price of natural gas to be determined by the market. We agree.

A case of remarkable similarities is *Northern.* In that case, Kansas required an interstate pipeline company to purchase gas ratably. The Kansas statute empowered the State Commission to "regulate the taking of natural gas from any and all... common sources of supply" to prevent the inequitable or unfair taking. *Id.* at 88. The rationale behind the state statute and the subsequent regulation was to effect ratable production and protect correlative rights. An interstate pipeline company challenged the orders claiming they unconstitutionally invaded the exclusive jurisdiction of the Federal Power Commission under the Natural Gas Act. The Supreme Court agreed, stating:

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas or for state regulations which would indirectly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain.

Id. at 91-92 (foot and citation omitted).

In *Transcontinental,* Mississippi required an interstate pipeline company to purchase gas from all parties owning interests in a common gas pool. Mississippi argued that the Natural Gas Policy Act of 1978 effectively nullifed *Northern* by vesting regulatory power in the states over the wellhead sales of gas. The Supreme Court concluded that the Mississippi Gas Board's order was pre-empted by the Natural Gas Act and the Natural Gas Policy Act of 1978. In so holding, he Supreme Court analyzed the case under the same standard used in *Northern* and decided that, by enacting the Natural Gas Policy Act of 1978, Congress

did not give to the states any broader powers over natural gas.

The district court determined that *Northern* and *Transcontinental* controlled the outcome below. We do not find Oklahoma's regulatory scheme to be distinguishable from the pre-empted regulations discussed in *Northern* and *Transcontinental.* We agree that all state regulation of the *purchasing or taking* of natural gas by interstate pipeline companies has been pre-empted by the federal regulations contained in the Natural Gas Act and the Natural Gas Policy Act of 1978. Under the *Silkwood* standards for pre-emption, these two acts evidence Congress' intent to occupy the entire field of regulating natural gas purchases by interstate pipeline companies.

The Commission now argues the district court misapplied *Northern* and *Transcontinental.* It suggests Congress has not pre-empted state regulation of conservation as the statutes in question clearly do not give to FERC any powers concerning these matters. The Commission contends this case does not involve state regulation of interstate natural gas sales and transportation but rather the state's inherent power to conserve its natural resources, protect correlative rights, and prevent waste, these arguments have no merit. The same arguments were raised in *Northern.* Kansas contended that ratable taking was essential for the conservation of natural gas and the protection of correlative rights, and that conservation is traditionally a function of state power. In *Northern,* the Supreme Court dealt with ths issue by saying the problem is not as to the existence or even the scope of a state's power to conserve its natural resources, rather it is a question of whether the Constitution sanctions the prticular means chosen by Kansas to exercise the conceded powers *if those means threaten effectuation of the federal regulatory scheme. Id.* at 93. The Court concluded the state's interest in conservation of natural gas does not warrant its direct interference with the purchase of natural gas. We conclude Oklahoma's ratable-take statute (§ 240) and Rule 1-305 are not permissible conservation measures, because they interfere with federal regulation of the purchase of natural gas. Even though the federal regulations do not address conservation, § 240 and Rule 1-305 are pre-empted

because they create an obstacle to full compliance with the objectives of the federal regulation. *Silkwood,* 464 U.S. at 248.

The Commission also asserts that Rule 1-305 constitutes regulation of production and was adopted, at least in part, pursuant to Okla. Stat. Ann. tit. 52, § 239 (1981). The Commission argues that if the states have the power to regulate and limit production, then they can also limit purchases to existing market demand under Oklahoma's comprehensive approach. This argument is without merit. The language of Rule 1-305 does not support this argument. Section 239, by its own words, is directed to producers of natural gas. Section 240 on the other hand is directed to "common purchasers" of natural gas. Rule 1-305 is directed only to "common purchasers." It cannot be said that Rule I-305 is merely regulating production.[4]

Under either analysis as set forth in *Silkwood,* the Oklahoma statute § 240, and administrative Rule 1-305 have been pre-empted and therefore can not be enforced.

The decision of the district court is AFFIRMED.

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[4]It should be noted that the trial court made no ruling concerning § 239, which gives the State of Oklahoma the power to regulate production.

APPENDIX B

FILED IN THE

UNITED STATES COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

ANR PIPELINE COMPANY, et al,

Plaintiffs,

v. No. CIV-85-1929-A

THE CORPORATION COMMISSION OF OKLAHOMA, et al.,

Defendants.

and

NORTHWEST CENTRAL PIPELINE CORPORATION,

Plaintiff,

v. No. CIV-85-1980-A

THE CORPORATION COMMISSION OF OKLAHOMA, et al.,

Defendants.

MEMORANDUM OPINION

This case is before the Court for consideration of plaintiffs' Motions for Summary Judgment. These actions seek a declaration that OKLA. STAT. ANN. Tit. 52, § 240 (1981) ("Section 240"), and the orders, rules and regulations promulgated thereunder by the Corporation Commission of the State of Oklahoma ("Commission"), are unconstitutional as applied to interstate pipeline purchasers. Plaintiffs allege that these rules and regulations contravene Article VI, Section 2 of the Constitution of the United States, because they interfere with the regulatory scheme established under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301

et seq., Additionally, the plaintiffs seek to enjoin the Commission and the individual Commissioners from enforcing its Section 240 rules against the interstate pipeline companies.

Plaintiffs specifically attack Commission Rule 1-305 on grounds that the subject matter, as applied to them, is exclusively in the federal province. Rule 1-305 provides:

"RULE 1-305. PRIORITY SCHEDULE FOR SUPPLY AND DEMAND IMBALANCE.

(a) Any common purchaser as defined in 52 O.S. 1981, Section 240, shall purchase all the gas which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another, except as authorized by the Commission under (b) below.

(b) In the interest of the prevention of waste and protection of correlative rights, the following priority schedule shall be implemented by any first purchaser of gas whenever the permitted production from all wells in ~~any common~~ source of supply in its system in this state, including gas which is processed, is in excess of that purchaser's reasonable market demand; provided, however, if the first purchaser does not contractually control wellhead production, then the first taker of gas shall be responsible for implementation of the following priority schedule.

(i) Priority One – Hardship and distress wells.

(ii) Priority Two – Enhanced recovery wells.

(iii) Priority Three – Wells producing casinghead gas and associated gas.

(iv) Priority Four – If after the first purchaser or first taker has taken the gas from Priorities One through Three above and still has further market demand in its system for gas, said purchaser or taker shall take ratably from all allocated, special allocated and unallocated common sources of supply which may be offered for sale, and which may reasonably be reached by its trunk lines

or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another.

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demand of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratable. All production from the lower priority wells shall be shut-in before production from any well in the next higher priority is curtailed.

(d) Any well which meets the definition of more than one priority shall be assigned the higher priority.

(e) When there is more than one purchaser or taker involved in the taking of gas from a well into any purchaser's system, all purchasers and takers within that system shall be responsible for compliance with this Rule.

(f) Upon a verified application of the Director of the Oil and Gas Conservation Division, or any other person, the Commission, after notice and hearing, may determine if gas has been ratably purchased or taken from a common source of supply on a systemwide basis in accordance with this rule without avoidable waste and with equitable participation in productions and markets by all operators and other interested parties.

(g) In any month wherein a purchaser or taker has a market demand/supply imbalance and must curtail purchases or takes in compliance with this Rule, Form 1004 B shall be filed by said purchaser or taker with the Oil and Gas Conservation Division.

(h) Any interersted party may file an application requesting that the Commission, for good cause shown, authorize limited deviation from the general priority schedule provided under (b) above. The Commission on its own motion may initiate a review of the continued need fo such a limited deviation. After notice and hear-

> ing, the Commission may authorize limited deviation upon finding that the same is necessary in order to prevent waste, protect correlative rights, or is otherwise required by the public interest or authorized by law."

When Rule 1-305 was promulgated, the Commission referred to Section 240 as its legal basis. Section 240 is a straightforward ratable take provision, which provides:

> "'Common purchaser' – Discrimination in purchases prohibited – Regulation of purchases
>
> Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all of the natural gas which may be offered for sale, and which may reasonably be reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production, or of production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing,

from the duty of purchasing gas of an inferior quality or grade."

Essentially the same controversy now before this Court has recently been examined twice by the United States Supreme Court. In *Northern Natural Gas Company v. State Corporation Commission,* 372 U.S. 84 (1963), the Court held unconstitutional on federal supremacy grounds the Kansas attempt to regulate the purchase of Kansas natural gas by interstate pipelines. As in *Northern Natural,* the defendants here assert that the state's police power interest in conservation of resources and consequent regulation of production obviate the kind of federal interest that would underlie a federal occupation of the field. At issue in *Northern Natural* were two orders of the Kansas State Corporation Commission, avowedly adopted as conservation measures. The Commission order of October 7, 1959 was superseded by Order number 82-2-219, which provides:

"RATABLE PRODUCTION OF GAS FROM COMMON SOURCE OF SUPPLY

In each common source of supply under proration by this Commission, each purchaser shall take gas in proporation to the allowables from all the wells to which it is connected and shall maintain all such wells in substantially the same proportionate status as to over-production or underproduction; provided, however, this rule shall not apply when a difference in proportionate status results from the inability of a well to produce proportionately with other wells connected to the purchaser (Authorized by G. S. 1959, Supp. 55-703; Effective February 8, 1960)."

Kansas statute Section 55-703 is:

"55-703. Production regulations; rules and formulas. Whenever the available production of natural gas from any common source of supply is in excess of the market demands for such gas from such common source of supply, or whenever the market demands for natural gas from any common source of supply can be fulfilled only by the production of natural gas therefrom under conditions

constituting waste as herein defined, or whenever the commission finds and determines that the orderly development of and production of natural gas from, any common source of supply requires the exercise of its jurisdiction, then any person, firm or corporation having the right to produce natural gas therefrom, may produce only such portion of all the natural gas that may be currently produced without waste and to satisfy the market demands, as will permit each developed lease to ultimately produce approximately the amount of gas underlying such developed lease and currently produce proportionately with other developed leases in said common source of supply without uncompensated cognizable drainage between separately-owned, developed leases or parts thereof.

The commission shall so regulate the taking of natural gas from any and all such common sources of supply within this state as to prevent the inequitable or unfair taking from such common source of supply by any person, firm or corporation and to prevent unreasonable discrimination of favor of any one common source of supply as against another in favor of or against any producer in any such common source of supply. In promulgating rules, regulations and formulas, to attain such results the commission shall give equitable consideration to acreage, pressure, open flow, porosity, permebility and thickness of pay, and such other factors, conditions and circumstances as may exist in the common source of supply under consideration at the time, as may be pertinent: *Provided, however,* That the daily takes of gas from any well in an unprorated gas pool shall not exceed twenty-five percent (25%) of its open flow: *Provided further, however,* That the provisions of this act shall not apply to any common source of supply in which the average open flow of all the producing wells therein is not in excess of seven hundred fifty thousand (750,000) cubic feet per day.

> The commission in determining the market demand for gas from a common source of supply shall consider the reasonable current requirements for current consumption and use within and without the state, and such other factors, conditions, or circumstances that would aid in establishing the market demand."

Thus the Kansas regulation fell notwithstanding its promulgation in furtherance of a *production* statute. The ostensible source for Oklahoma's Rule 1-305 was Section 240, a *purchase* statute. In its briefs here, the Commission cites its order of July 3, 1985 in which it propounded that Rule 1-305 was also a product of OKLA. STAT. ANN. Tit. 52 § 239 (1981), a *conservation* statute. This order came down a year and a half after the effective date of Rule 1-305. There is no need to inquire whether the July 1985 order's invocation of Section 239 is but an afterthought makeweight, because in any event it has no more efficacy in fending off a federal exclusive province than the Kansas statute examined by the Supreme Court in *Northern Natural.*

A similar result was reached in the recent *Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi and Coastal Exploration, et al.,* No. 84-1076, United States Supreme Court, decided January 22,1986, _____ U.S. _____. In *Transco,* the Court examined Rule 48 of the Mississippi State Oil and Gas Board, a ratable-take requirement, which provides:

> "Rule 48. *Ratable Take*
>
> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply."

A comparison of the two regulations found unconstitutional, Kansas Statute 55-703 and Mississippi's Rule 48, with Oklahoma's Section 240 and Rule 1-305, compels a determination that all three devices are intended to and do result in regulation of the *taking* of gas. They seek to prevent discrimination in favor of any one common source of supply as against another. Such

regulation allows an individual state to skew the free market for gas. The federal policy is to allow the gas market price to be determined by the free flow of commerce on a national scale among the separate states.

As discussed in *Transco,*

> "[I]n light of Congress' intent to move torward a less-regulated national natural gas market, its decision to remove jurisdiction from FERC [Federal Energy Regulatory Commission] cannot be interpreted as an invitation to the States to impose additional regulations.
>
> Mississippi's order also runs afoul of other concerns identified in *Northern Natural.* First, it disturbs the uniformity of the federal scheme, since interstate pipelines will be forced to comply with varied state regulations of their purchasing practices. In light of the NGPA's unification of the interstate and intrastate markets, the contention that Congress meant to permit the States to impose inconsistent regulations is especially unavailing. Second, Mississippi's order would have the effect of increasing the ultimate price to consumers." p. 13, Slip Opinion.

In the case at bar, the Commission has asserted that it is a constitutionally created body statutorily charged with the duties of regulating waste and protecting correlative rights. Further, the Commission asserts its regulation of natural gas takes by interstate pipelines is only incidental to the exercise of its jurisdiction over the regulation of the production of natural gas from a common source of supply. Through its applications of Sections 239 and 240 and regulations promulgated thereunder, the Commission urges, it is attempting to accommodate the interests of both the producer and the pipeline by adjusting the production of natural gas to demand. It argues that Federal Energy Regulatory Commission ("FERC") does not regulate the production and gathering of gas that ultimately may be sold in interstate commerce, but rather has cognizance of the construction of interstate pipelines, sales for resale and the terms and conditions of transportation of natural gas by interstate pipelines.

The Commission urges that with regard to the "first sales" of natural gas, the only area over which FERC may exercise its control is to set maximum lawful price ceilings, citing *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company*, 463 U.S. 319, 334 (1983); and thus, as the Commission's questioned activities are directed toward production and the first purchaser, whether it be pipeline, gathering system, or independent marketer, such activities constitute permissible acts under the law.

The Court finds that OKLA. STAT. ANN. Tit. 52 § 240 (1981) and Rule 1-305 of the Oklahoma Corporation Commission are unconstitutional as applied to plaintiffs.

There are two bases for the decision in *Northern Natural.* The first, that the states may not impose inconsistent requirements, clearly applies here.

Further, despite the values of recognition of correlative rights and conservation, the Oklahoma statute and the Commission's Rule, as did the action of the State Oil and Gas Board of Mississippi in *Transco*, "...directly undermines Congress' determination that the supply, the demand, and the price of high-cost gas be determined by market forces." *Transco, supra.*

The subject matter has been pre-empted by federal law, which, as Justice Renquist observed in footnote 3 of his dissent, can occur either through an actual conflict of federal law or a congressional intent to occupy a given field.

Transco tells us in so many words that this is a subject matter in which Congress has determined a national policy, before which Oklahoma law must bow.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that:

1. OKLA. STAT. ANN. Tit. 42, §240 (1981) and Rule 1-305 of the Oklahoma Corporation Commission are declared unconstitutional as applied to the plaintiffs, intervenors and all other interstate pipeline companies, in that such statute and rule are in contravention of Article VI, Section 2 of the Constitution of the United States of America as such regulation of interstate pipeline company by the State of Oklahoma interferes with and is pre-empted by the federal regulatory scheme established by

the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*

2. Because OKLA. STAT. ANN. Tit. 52, § 240 (1981) and Rule 1-305 are violative of the United States Constitution, defendants, The Corporation Commission of The State of Oklahoma, James B. Townsend, Norma Eagleton and Hamp Baker, Commissioners of the Corporation Commission of the State of Oklahoma, and all persons acting under, in concert with, for, or on behalf of, the defendants, are permanently enjoined from engaging in, committing or performing or causing to be done, directly or indirectly, any acts which implement, enforce or attempt to implement or enforce the provisions of OKLA. STAT. ANN. Tit. 52, § 240 (1981) or Rule 1-305 as against the plaintiffs, the intervenors or any other interstate pipeline company.

3. The declaratory judgment entered pursuant to paragraph 1 and the permanent injunction entered pursuant to paragraph 2 of this Order shall constitute a final judgment pursuant to Rule 54 of the Federal Rules of Civil Procedure, and the Clerk of the Court is directed to enter the same in the judgment docket pursuant to Rules 58 and 79(a) of the Federal Rules of Civil Procedure.

4. Each of the parties shall bear their own costs and attorneys fees.

ENTERED this 4th day of September, 1986.

WAYNE E. ALLEY
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

ANR PIPELINE COMPANY; COLORADO INTERSTATE GAS COMPANY; COLUMBIA GAS TRANSMISSION CORP.; KN ENERGY, INC.: MISSISSIPPI RIVER TRANSMISSION CORP.: NATURAL GAS PIPELINE COMPANY OF AMERICA; TENNESSEE GAS PIPELINE CO.,

Plaintiffs-Appellees,

WILLIAMS NATURAL GAS COMPANY,

Plaintiffs-Appellees,

EL PASO NATURAL GAS COMPANY,

Plaintiff-Intervenor-Appellee,

WESTERN GAS INTERSTATE COMPANY,

Plaintiff,

v. No. 86-2481

THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA,

Defendant-Appellant,

SOUTHERN NATURAL GAS COMPANY,

Defendant-Appellee and Defendant-Intervenor-Appellant,

JAMES B. TOWNSEND, NORMA EAGLETON, and HAMP BAKER, Commissioners of the Corporation Commission of the State of Oklahoma,

Defendants.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that the Oklahoma Corporation Commission, the appellant above-named hereby appeals to the Supreme Court of the United States from the final order dismissing the complaint entered in this action of November 9, 1988.

This appeal is taken pursuant to 28 U.S.C. §1254.

Respectfully submitted,

Lindil C. Fowler, Jr.
Leslie Wilson Pepper
Patricia A. Watts
Counsel for Appellant
OKLAHOMA CORPORATION COMMISSION
2101 North Lincoln Boulevard
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(405) 521-2255

Certificate of Mailing

I certify that on this 4th day of January, 1989, I mailed copies of the foregoing Notice of Appeal to the U.S. Supreme Court, postage pre-paid to the following parties:

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I further certify that all parties required to be served have been served.

Patricia A. Watts

APPENDIX D

§239. Common source of supply – Excess gas supply – Apportionment and regulation to prevent waste

Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm, or corporation securing any unfair proportion of the gas therefrom; provided, that the Corporation Commission may by proper order, permit the taking of a greater amount whenever it shall deem such taking reasonable or equitable. The said commission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in favor of any one such common source of supply as against another.

Laws 1915, c. 197 §4.

§240. "Common purchaser" – Discrimination in purchases prohibited – Regulation of purchases

Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all the natural gas which may be offered for sale, and which may reasonably be reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against

another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production, or of production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

Laws 1915, c. 197, §5.

APPENDIX E

*RULE 1-305. *PRIORITY SCHEDULE FOR SUPPLY AND DEMAND IMBALANCE*

(a) Any common purchaser as defined in 52 O.S. 1981, Section 240, shall purchase all the gas which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another, except as authorized by the Commission under (b) below.

(b) In the interest of the prevention of waste and protection of correlative rights, the following priority schedule shall be implemented by any first purchaser of gas whenever the permitted production from all wells in any common source of supply in its system in this state, including gas which is processed, is in excess of that purchaser's reasonable market demand; provided, however, if the first purchaser does not contractually control wellhead production, then the first taker of gas shall be responsible for implement of the following priority schedule.

(i) Priority One – Hardship and distressed wells.

(ii) Priority Two – Enhanced recovery wells.

(iii) Priority Three – Wells producing casinghead gas and associated gas.

(iv) Priority Four – If after the first purchaser or first taker has taken the gas from Priorities One through Three above and still has further market demand in its system for gas, said purchaser or taker shall take ratably from all allocated, special allocated and unallocated common sources which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another.

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demand of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratable.

All production from the lower priority wells shall be shut-in before production from any well in the next higher priority is curtailed.

(d) Any well which meets the definition of more than one priority shall be assigned the higher priority.

(e) When there is more than one purchaser or taker involved in the taking of gas from a well into any purchaser's system, all purchasers and takers within that system shall be responsible for compliance with this Rule.

(f) Upon a verified application of the Director of the Oil and Gas Conservation Division, or any other person, the Commission, after notice and hearing, may determine if gas has been ratably purchased or taken from a common source of supply on a systemwide basis in accordance with this rule without avoidable waste and with equitable participation in production and markets by all operators and other interested parties.

(g) In any month wherein a purchaser or taker has a market demand/supply imbalance and must curtail purchases or takes in compliance with this Rule, Form 1004 B shall be filed by said purchaser or taker with the Oil and Gas Conservation Division.

(h) Any interested party may file an application requesting that the Commission, for good cause shown, authorize limited deviation from the general priority schedule provided under (b) above. The Commission on its own motion may initiate a review of the continued need for such a limited deviation. After notice and hearing, the Commission may authorize limited deviation upon finding the that the same is necessary in order to prevent waste, protect correlative rights, or is otherwise required by the public interest or authorized by law.

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*Rule 1-305 has been amended since the instigation of these proceedings to include a fifth category.

APPENDIX F

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN RE: WHETHER THE OKLAHOMA CORPORATION COMMISSION HAS THE AUTHORITY TO REQUIRE RATABLE TAKE OF NATURAL GAS BY FIRST PURCHASERS WHO ARE INTERSTATE PIPELINES.	GENERAL CAUSE NO. 28770 ORDER NO. 281285

ORDER DETERMINING AUTHORITY OF THE COMMISSION TO REQUIRE RATABLE TAKES OF NATURAL GAS BY FIRST PURCHASERS WHO MAY BE INTERSTATE PIPELINES

I. Procedural History

On January 9, 1984, the Oil and Gas Conservation Division of the Corporation Commission filed a Notice of Inquiry and Motion to Consolidate Causes as a result of numerous causes filed pursuant to 52 O.S. 1981, §240, and rules promulgated thereunder. Exhibit "A" attached hereto and incorporated herein lists the pending causes. The Commission en banc heard oral argument on said motions and issued Order No. 254451 on February 27, 1984, which consolidated the causes and divided them into two phases, the first phase involving a review of Commission jurisdiction and the second phase to separate and continue any further proceedings on an individual case basis. In addition, Order No. 254451 set forth a briefing and oral argument schedule and established a hearing panel to take evidence and to consider the following issues common to the consolidated causes:

1. Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforcing the requirements of 52 O.S. 1981, §240, requiring the ratable taking of gas against interstate pipelines which are the first purchasers of Oklahoma-produced natural gas?
2. Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, §§239 and 240?

Order No. 254451 was published as required by law and the rules of the Commission. Procedural directives regarding the filing of briefs, notices of intention to participate and scheduling of oral arguments were issued by the hearing panel on May 3, 1984, and May 17, 1984. Oral argument was had before the hearing panel on May 21, 1984, at which time all interested parties had an opportunity to present testimony. On September 4, 1984, the report of the hearing panel issued recommending that the issues presented to them be answered in the negative. The report was filed with the Secretary of the Commission on September 7, 1984. Exceptions and written comments were filed and oral argument was had before the Commission sitting en banc on October 17, 1984, at the close of which the cause was taken under advisement. By the filing of briefs or an entry of appearance or by an entry of appearance made at the time of oral argument, some 113 parties participated in this cause as listed on Exhibit "B" to this order. The parties will hereinafter be referred to as "Proponents" (those arguing in favor of Commission jurisdiction) and "Opponents" (those in opposition to Commission jurisdiction).

The Commission is aware that numerous authorities have been cited in support of each position and has addressed herein those most frequently cited or most supportive of the respective positions. All issues have been exhaustively briefed and argued and the Commission appreciates the efforts of all participants.

II. Oklahoma Statutory Scheme and Commission Rules Promulgated Thereunder

The focus of Commission inquiry in this matter is on 52 O.S. 1981, §§239 and 240 (hereinafter Section 239 and Section 240). These statutes were enacted in 1915 and have not been amended. Sections 239 and 240, provide as follows:

> SECTION 239. Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm, or corporation securing any unfair proportion of the gas therefrom; provided, that the Corporation Commission may by proper order, permit the taking of a greater amount whenever it shall deem such taking reasonable or equitable. The said commission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in favor of any one such common source of supply as against another.
>
> SECTION 240. Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all the natural gas which may be offered for sale, and which may reasonably be reached by its trunk lines, or gathering lines without

> discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production, or of production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

On October 19, 1983, this Commission promulgated rules pursuant to these sections, effective January 1, 1984, which established a priority schedule for takes of natural gas where a supply and demand imbalance is present within a first purchaser's system within the State of Oklahoma. At the hearing before the panel of hearing officers on May 21, 1984, the panel ruled that reference could be made to the "Priority Rules" within the context of arguments on the constitutional issues since the priority rules (1) are an example of the type of authority the Commission seeks to assert over interstate pipelines; (2) were promulgated under the authority of Sections 239 and 240, which statutes are here the subject of constitutional inquiry; and (3) are final and unappealable. A copy of the final rules is attached hereto as Exhibit "C" and incorporated herein.

III. Arguments and Authorities

IS THE STATE OF OKLAHOMA PREEMPTED BY THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION FROM ENFORCING THE REQUIREMENTS OF 52 O.S. 1981, §240, REQUIRING THE RATABLE TAKING OF GAS AGAINST INTERSTATE PIPELINES WHICH ARE THE FIRST PURCHASER OF OKLAHOMA-PRODUCED NATURAL GAS?

Opponents argue that Commission regulation of pipeline takes will impermissably burden interstate commerce for the reasons that prices of natural gas will increase, costs of administration, construction, and operation will increase and contractual obligations will be impaired. Further, opponents believe that these statutes are discriminatory and protectionist in nature which are prohibited by the Commerce Clause, relying primarily on *Hughes v. Oklahoma*, 441, U.S. 322 (1979); *Philadelphia v. N.J.*, 437 U.S. 617 (1978); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949); *Tenneco, Inc. v. Sutton*, 530 F.Supp. 411 (D.C. La. 1981); and *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F.Supp 522 (W.D. Okl. 1973), aff'd, 415 U.S. 961 (1974). In *Hughes v. Oklahoma, supra,* the Supreme Court found an Oklahoma statute which provided that no person could "transport or ship [minnows]...for sale outside the state" violative of the Commerce Clause for the reason that the statute on its face discriminated against interstate commerce and that a legitimate local purpose was not ascertainable, reversing a previous position concerning wild animals and fish. 441 U.S. at 335-339. Likewise, a New Jersey statute prohibiting the importation of "solid or liquid waste which originated or was collected outside the territorial limits of the state..." was held to be violative of the Commerce Clause in *Philadelphia v. N.J., supra,* for its discriminatory effect and its attempt to protect the State from the common problem of waste. 437 U.S. at 618. In *H.P. Hood & Sons v. Dumond, supra,* the Court found that a New York statute as applied to the licensing of milk distributors was offensive to the Commerce

Clause in that the purpose was to promote the State's economic advantage by curtailing interstate commerce. In *Tenneco v. Sutton, supra,* the Court found, inter alia, that Louisiana's statutes and regulations governing the offer to purchase gas by local users before it is offered to interstate users was clearly economic protectionism with no legitimate local purpose. 530 F.Supp. at 440. Finally, an Order by the Oklahoma Corporation Commission setting a minimum price level for natural gas was found to be protectionist in *Federal Power Commission v. Corporation Commission, supra,* as the purpose was not to prevent waste or protect correlative rights. 362 F. Supp. at 538. These cases clearly establish that a legitmate local interest must be the basis for a nondiscriminatory statute that effects interstate commerce and that such interest must outweigh any burden placed on interstate commerce.

Proponents argue that the exercise of state regulation over pipeline takes is constitutionally permissible in that the impact on interstate commerce is merely incidental. In addition, it is argued that the Oklahoma ratable take provisions are essentially directed toward the production of natural gas, an activity that is not considered interstate commerce. Finally, reliance is placed on *Cities Service Gas Company v. Peerless Oil and Gas Company,* 340 U.S. 197 (1950), (hereinafter *"Peerless"*) in which the United States Supreme Court held that orders of the Oklahoma Corporation Commission setting natural gas prices and directing an interstate pipeline to make a well connection and take ratably pursuant to Section 240 did not impermissibly burden interstate commerce.

Discussion

All parties agree that the general test for determining whether or not a state statute impermissibly impacts interstate commerce has been set forth in *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970), wherein the United States Supreme Court stated:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates

> evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are not only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. *Huron Cement Co. v. City of Detroit,* 362 U.S. 440, 443, 80 S.Ct. 813, 816, 4 L.Ed.2d 852. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

With regard to the first prong of the test under *Pike,* whether the statute is discriminatory, a plain reading of Section 240 demonstrates that all pipelines are subject to its terms "[w]henever the full production from any common source of supply of natural gas in this state is in excess of the market demands..." Section 239. It must be emphasized that Section 240 does not stand alone in its application; that it must be read in conjunction with Section 239 as a means for accomplishing the state's objective.

Section 239 sets forth circumstances for the allocation and regulation of the production of natural gas when supply exceeds demand. In addition to regulating the flow of production, another means for accomplishing the objectives explicitly authorized by Section 239 is to regulate the taking of natural gas from a common source of supply. The latter method of regulating production is more fully discussed in Section 240 which provides guidelines for the regulation of takes. The Commission's exercise of jurisdiction over interstate pipelines is therefore incidental to its jurisdictional mandate to regulate production pursuant to Section 239 and a tool for enforcing such production regulation.

The next prong of the test to determine whether these state statutes contravene the Commerce Clause is to identify a "legitimate local public interest" to which the regulation is directed. The state's exercise of its police power in promoting conservation of its natural resources by preventing waste and protecting correlative rights has long been recognized as a legitimate state interest. *See, generally, Peerless,* ("That a legitimate local interest

is at stake in this case is clear. A state is justifiably concerned with preventing rapid and uneconomic dissipation of one of its chief natural resources.") 340 U.S. at 187; *Champlin Refining Co. v. Corporation Commission,* ("In Oklahoma, as generally elsewhere, landowners do not have absolute title to the gas and oil that may permeate the surface. These minerals, differing from solids in place such as coal and iron, are fugacious and of uncertain movement within the units of the pool. Every person has the right to drill wells on his own land and take from the pools below all the oil and gas that he may be able to reduce to possession including that coming from land belonging to others, but the right to take and thus acquire ownership is subject to the reasonable exertion of the power of the State to prevent unnecessary loss, destruction, or waste and that power extends to the taker's unreasonable and wasteful use of natural gas pressure available for lifting oil to the surface and the unreasonable and wasteful depletion of a common supply of gas and oil to the injury of others entitled to resort to and take from the same pool." [citations omitted]) 286 U.S. 210 at 233-234 (1932); *Walls v. Midland Carbon Co.,* ("The determining consideration is the power of the state over, and its regulation of, a property in which others besides the companies may have rights and in which the state has an interest to adjust and preserve, natural gas being one of the resources of the state. And in this consideration it is more important to consider not for what a particular owner uses the gas, but the proportion of his use to that of others; or it may be, the prevention of use by others;") 254 U.S. 300 at 319 (1920).

Having established a legitimate local interest, the remaining prong of the *Pike* test focuses on the degree of burden which is placed on interstate commerce by the state regulation. It is contended by some proponents that a producer's ability and right to produce gas always has an incidental effect on the purchaser's takes. Likewise, the supervision of those takes as a necessary means of regulating production incidentally affects interstate commerce. However, opponents believe that the burden of complying with Oklahoma's ratable take requirements directly interferes with interstate commerce.

In response to these contentions, and in support of Commission jurisdiction, proponents note that interstate pipelines presently maintain records and conduct operations in conformity with special allocated gas pool field-wide rules similar to what would be required for compliance with prorated takes. While opponents appear to speculate as to imagined burdens of costs and operational responsibilities, one interstate pipeline represented that it had adopted on its own initiative a ratable take procedure which has not burdened the company nor interstate commerce.

Opponents also allege that natural gas prices will increase as a result of increased construction and operational costs as well as contractual liabilities and obligations, thereby burdening interstate commerce. It is noted that the Commission has always had jurisdictional supervision over the construction and operation of gathering lines of interstate pipelines pursuant to the Natural Gas Act of 1938 (hereinafter NGA). In fact, the Federal Regulatory Commission (hereinafter FERC) has formulated various tests to apply to pipelines in determining whether they are subject to the jurisdiction of the NGA. *See, e.g., Phillips Petroleum Company,* 10 FPC 246, 277 (1951), rev. on other grounds, 347 U.S. 672 (1954) ("behind the plant" theory); *Barnes Transportation, Inc.,* Opinion No. 306, 18 FPC 369 (1957) ("central point test") and *Ben Bolt Gathering Company,* 26 FPC 825 (1961), aff'd., 323 F.2d 610 (5th Cir. 1963) ("primary function" test). If exempted pursuant to Section 1(b) of the NGA, 15 U.S.C. §717(b), this Commission may exercise its jurisdiction over the construction and operation of the pipeline. Of course, any proposed construction or service of an interstate pipeline would require certificated approval by the FERC prior to the commencement where the costs would be subject to scrutiny as to their reasonableness by that agency. The Commission is unpersuaded that the speculative costs constitute an impermissible burden as companies are often required to expend large sums of money to comply with governmental regulations.

Opponents also contend a burden is placed on interstate commerce by the possibility that an interstate pipeline may incur contractual liabilities ("take or pay" obligations) as a result

of state regulation. It is also argued that a pipeline's average cost of gas will be increased for the reason that the price of noncontractual parties' gas will be higher, thereby burdening interstate commerce. Proponents counter argue that any contractual liability would be suspended and superseded by state law, thereby alleviating any direct burden on interstate commerce. Proponents also contend that the cost of gas is not an issue as the NGPA has statutorily set price ceilings on natural gas or deregulated certain categories, requiring the FERC to investigate only those circumstances involving misrepresentation of the price paid or abuse rising to the level of "reckless disregard" in its ratemaking practices. Further, it is asserted by proponents that pipelines would not be required to take gas in excess of their market demand as contended, and would, indeed, have flexibility in their purchase patterns as reflected in the priority schedule of Rule 1-305, Exhibit "C", attached hereto.

The Commission recognizes that some interstate pipelines are presently exposed to liability under existing contractual obligations and that this liability is frequently at issue in pipeline rate cases and rulemakings before FERC, in state and federal courts and in private settlement discussions. The Commission is reluctant, however, to project an economic scenario based on hypothetical fears on which to rest its decision. Rather, the Commission is of the opinion that it is, in fact, exercising incidental jurisdiction over takes of gas while regulating production and furthering the legitimate state interest in protecting correlative rights and preventing waste. When applying the *Pike* test to the instant situation, it appears the weight of the scales is toward the exercise of the state's police power over production and enforcement thereof through the prorationing of takes. There is no method of promoting the state's interest which would have a lesser impact on interstate activities and to conclude otherwise would subject the state's power to protect its interest to that of private contracting practices.

Opponent's contention that these statutes are protectionist in nature must be rejected as there is no evidence that this state is placed in a position of economic isolation, enhancing its economy while depriving a sister state of economic benefits.

The United States Supreme Court has noted that "...a state law constitutes 'economic protectionism' on proof either of discriminatory effect, *see Philadelphia v. New Jersey*, or of discriminatory purpose, *see Hunt v. Washington Apple Advertising Comm'n*, 432 U.S., at 352-353", *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 at 471 (1981). The record contains no evidence of either situation. Indeed, the statutes apply to both interstate and intrastate pipelines which precludes claims of discrimination and protectionism.

Proponents also rely on the *Peerless* decision as being persuasive in light of the Court's consideration of the Commerce Clause challenge to Sections 239 and 240. We are mindful that the Court's analysis of the State's order setting prices is no longer valid under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), but believe that the Court's analysis of the state's conservation measures as determined by the Legislature in enacting Sections 239 and 240 is precedential.

In *Peerless*, the Supreme Court reviewed the Oklahoma statutory scheme and agreed with the Oklahoma Supreme Court that sEctions 239 and 240 did not violate the Commerce Clause of the Federal Constitution. 340 U.S. at 184-185. It recognized that "...a state may adopt reasonable regulations to prevent economic and physical waste of natural gas," noting that "[t[his Court has upheld numerous kinds of state legislation designed to curb waste of natural resources and to protect the correlative rights of owners through ratable taking (citations omitted)." 340 U.S. at 185. The Supreme Court's consideration and constitutional pronouncement regarding the Oklahoma statute does lend support for its validity.

And, finally, proponents contend that the proposed regulation is an incident of production and not part of interstate commerce. *See, Champlin Refining Co. v. Corporation Commission, supra*, at 236. While opponents disagree, it seems only logical that when production is dictated by pipeline capacity and demand and limited by this agency's setting of an allowable, the pipeline must be an integral part of that production function and regulation. Section 239 sets forth the circumstances under which prorating occurs and Section 240 provides a means of

enforcing proration requirements. In this regard, the exercise of jurisdiction over interstate pipelines is incidental to this Commission's statutory responsibilities to protect correlative rights and prevent waste, a function of the regulation of production. As such, any incidental effect on interstate pipelines and interstate commerce is permissible.

IV. Arguments and Authorities

DOES THE FEDERAL ENERGY REGULATORY COMMISSION UNDER THE NATURAL GAS ACT OF 1938 AND THE NATURAL GAS POLICY ACT OF 1978 ("NGPA") HAVE SOLE AUTHORITY OVER THE REGULATION OF GAS PURCHASES BY INTERSTATE PURCHASERS OF NATURAL GAS THEREBY PREEMPTING THE STATE OF OKLAHOMA FROM ACTING UNDER 52 O.S.1981, §§239 AND 240.

Opponents contend that the regulation of pipeline takes interferes with the regulatory scheme established by the NGA and NGPA which is administered by the FERC. In particular, it is alleged that state regulation of pipeline takes is prohibited in that the FERC has exclusive jurisdiction over the sale and transportation of natural gas. It is contended that requiring ratable takes by pipelines would affect the price of that gas and certificated services which jurisdiction is exclusively that of the FERC. Reliance is placed on *Northern Natural Gas Co. v. State Corporation Commission of the State of Kansas,* 372 U.S. 84 (1963), (hereinafter *"Northern Natural"*) in which the United States Supreme Court held as void an order of the Kansas Corporation Commission requiring a gas pipeline purchaser to take ratably from all producers supplying it with gas from a common source of supply. Other authorities which opponents cite to support their preemptive view are *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company,* 463 U.S. 319, (1983); *Exxon Corporation v. Eagerton,* 462 U.S. 176 (1983); *Maryland v. Louisiana,* 451 U.S. 725, (1981); *California v. Southland Royalty Company,* 436 U.S. 519, (1978); *Tenneco, Inc. v. Sutton, supra.*

Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra, involved a review of two orders promulgated by the FERC. The first order defined "first sale" pursuant to the NGPA as applied solely to interstate pipeline sales of natural gas and commingled independent-producer and pipeline-producer gas sales. The second order promulgated regulations under the NGA setting prices for pipeline production. The Supreme Court reviewed the natural gas regulatory pricing history and philosophy finding that:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas. 463 U.S. at 331.

After a review of NGPA provisions and congressional intent, the Court concluded that the FERC orders pricing pipeline production differently than other production were "inconsistent with the statutory mandate (and would) frustrate the policy that Congress sought to implement." [citation omitted]. This case is instructive insofar as explaining the effect of the NGPA on the first sale of natural gas.

An Alabama statute which prohibited oil and gas producers from passing through severance tax increases to purchasers was held preempted by federal law as to the sale of gas in interstate commerce in *Exxon Corporation v. Eagerton, supra.* The statute also prohibited producers from passing the 2% tax increase through to consumers and exempted royalty owners from the percentage tax increase which the Court found permissible under the NGPA. This case illustrates the limitation of a state's direct imposition of price regulation on interstate commerce versus its ability to regulate the intrastate market. Likewise when Louisiana imposed a "first use" tax on gas imported into the State from principally the Outer Continental Shelf, the Supreme Court held the law unconstitutional as violative of the Supremacy and Commerce Clauses. *Maryland v. Louisiana, supra.* After considering various procedural aspects, the Court

found that "the effect of §1303C (part of First-Use Tax) is to interfere with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749. The Court's concern was that the one effect of the tax was to preclude FERC approval of expenses. 451 U.S. 750.

California v. Southland Royalty Company, supra, upheld a Federal Power Commission ("FPC," predecessor to FERC) order which found that gas dedicated to interstate commerce could not be diverted to the intrastate market without authorization of abandonment of service. This case was decided without consideration of the NGPA, but is a good review of the FPC's jurisdiction under the NGA. However, the exclusive authority of the FERC to regulate certificated service is not in question in this matter — only the ability of the state to regulate production through prorationing of takes.

The Louisiana statutes granting preferential treatment to Louisiana users and consumers were found to be preempted by the NGA and NGPA in *Tenneco, Inc. v. Sutton, supra,* for the reasons that there was a direct conflict with federal statutory provisions and the purposes and objective of the NGPA and NGA were frustrated. 530 F. Supp. at 437-438. This conclusion was reached after a consideration of the congressional histories of the federal acts and an extensive review of the caselaw. Opponents' authorities support the proposition that direct regulation of the transportation and sale of natural gas in interstate commerce is impermissible. However, it is contended that the Oklahoma statutory scheme does not directly regulate these areas.

Proponents assert that Oklahoma's ratable take statutes are directd toward the "production or gathering of natural gas" within the 1(b) exemption of the NGA, 15 U.S.C. §717(b), and not to the transportation or sale of natural gas. Further, proponents contend that the passage of the NGPA has increased state regulation of oil and gas and eliminated any previously existing federal preemption. They further contend that the holding in *Northern Natural* has been eroded in light of the passage of the NGPA and that state and federal regulation of different aspects of an interstate pipeline is permissible. Support

for these positions is primarily placed on *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, discussed *supra; Tenneco, Inc. v. Sutton*, discussed *supra; Penzoil Company et al. v. FERC*, 645 F.2d 36 (5th Cir. 1981); *Mobil Oil Exploration and Producing Southeast, Inc.*, FERC Docket No. CI 77-41000, 18 FERC §61,266 (1982).

The Court in *Penzoil Co. v. F.E.R.C., supra*, addressed the issue "[m]ay 'area rate clauses' in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978?" 645 F.2d at 365. The Court reviewed the NGPA and the Commission's responsibilities thereunder and upheld the FERC's orders permitting price escalation. Proponents have cited this case in support of their position that the NGPA has altered the regulatory outlook of the FERC.

Of particular interest is *Mobil Oil Exploration and Producing Southeast, Inc., supra*, in which the FERC reviewed relevant caselaw and commented on the agency's position concerning the 'production and gathering exemption', concluding:

> [I]t is clear that the production and gathering extends to the physical activities and processes involved in producing and gathering gas, as well as to the properties and facilities used in production and gathering. Congress left to the states the power to regulate these areas in order that the states could further their own legitimate interests in such matters as the conservation of their natural resource supplies, the prevention of waste, the economical and efficient development of their mineral resources, and the protection of the correlative rights of individual mineral interest owners. 18 FERC §61,266.

In determining whether a state law is preempted by federal law, one must "start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Thus, where Congress explicitly states its intention to preempt state regulation

in a specific area, or a "scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it," state regulation is barred. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. at 230. A review of the federal regulatory scheme demonstrates no express prohibition against state regulation of gas purchased by interstate pipelines as an incident of discharging the state's recognized interest in regulating production. It is also believed that the exercise of state and federal jurisdiction can coexist and work harmoniously as different aspects of the pipeline's business activities are regulated. The primary objective in resolving preemption issues is to attempt to accommodate state and federal interests. A review of the federal regulatory framework should assist this analysis.

The NGA conferred authority on the FPC to regulate natural gas companies engaged in the construction of facilities and transportation and sales of natural gas in interstate commerce. FPC jurisdiction was expanded to include regulation of producer sales to pipelines of natural gas prices pursuant to *Phillips Petroleum Company v. Wisconsin, supra.* Congress expressly provided that the NGA would not apply to "any other transportation or sale of natural gas or to local distribution of natural gas or to the facilities used for such distribution or to the production and gathering of natural gas." 15 U.S.C. §717(b). Therefore, federal jurisdiction under the NGA and *Phillips* was primarily directed toward the construction of facilities and transportation, sale and price of natural gas. As a result of a bifurcated gas market and inadequate interstate supply of gas, Congress enacted the NGPA which categorized natural gas and established a statutory maximum lawful price for certain categories, while deregulating others. *See, Tenneco, Inc. v. Sutton, supra,* at pages 418-420, for an overview of the NGPA. The establishment of statutory rates had the effect of supplanting FERC's "authority to establish rates for the wholesale market." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra,* at 331. The statutory price paid for natural gas is deemed just and reasonable. *See,* 15 U.S.C. §343 1(b)(1)(A); *Public Service Commission of New York v. Mid-Louisiana Gas Co., supra,* at 334.

While it is clear that the establishment of just and reasonable rates over the construction and transportation of natural gas and sale to its customers by interstate pipelines is an exclusive area reserved to the FERC, it is certain that Congress did not intend FERC to regulate production through requiring ratable takes by pipelines. Although the Court in *Northern Natural* explicitly rejected the application of the "production and gathering" exemption to those set of facts, the invalidation of Kansas' common purchaser statutes rested on other grounds. One learned commentator has suggested that the Court was primarily concerned with the effect that the ratable take order could have on the price of gas to the consumer as "the fundamental purpose of FPC jurisdiction to regulate the sale of gas at the wellhead is to control prices for the benefit of the ultimate consumer." Meyers, "Federal Preemption and State Conservation in Northern Natural Gas," 77 Harvard Law Review 689 at 696 (1964). As proponents have pointed out, the federal regulatory focus has shifted from consumer protection to establishing price incentives for the exploration and development of natural gas reserves. In addition, the issue in *Northern Natural* was not whether the state had the power to regulate, but whether "the particular means chosen...threaten effectuation of the federal regulatory scheme." *Northern Natural, supra,* at 93. *Northern Natural's* precedential value is therefore questionable in light of the passage of the NGPA.

However, preemption may also be inferred when "compliance with both federal and state regulations is a physical impossibility." *Florida Lime and Avocado Growers v. Paul,* 373 U.S. 132, 142-143 (1963). Opponents complain that compliance would be burdensome and that there may be conflicts with certificated service, but the circumstances here do not reveal that compliance with the federal and state requirements would be a "physical impossibility." Both the state and federal regulatory schemes contemplate the exercise of independent business judgment by the regulated in managing their business while complying with the applicable laws. Any hypothetical conflict of state and federal law can either be avoided by prudent management or encouraged by deliberate actions. However, the Commission

believes that proper planning in the decision-making process of this regulated industry will result in the accommodation of all interests.

And, finally, "preemption of a state statute may be found when that statute stands as an obstacle to the accomplishment of the full purposes and objects of Congress." *Jones v. Rath Packing Co.*, 430 U.S. at 526, 540-41, quoting *Hines v. Davidowitz*, 312 U.S. 52, at 67 (1941). It is claimed that the Oklahoma statute intrudes upon the exclusive federal jurisdiction over interstate pipelines and their practices, but this proposition must be rejected. The FERC's responsibility to determine just and reasonable prices over the "first sale" of natural gas has been replaced by categorical price ceilings on natural gas. Congressional objectives have changed since the passage of the NGPA to encourage exploration for, and development of, natural gas reserves. In this regard, the Oklahoma statutes complement the federal objective as they attempt to prevent waste, thus preserving natural gas for the future.

The Oklahoma Supreme Court has stated on several occasions that this Commission "may employ such means as may be reasonably necessary to accomplish the declared purposes" of Section 239. *See, Corporation Commission v. Phillips Petroleum Company*, 536 P.2d 1284 (Okl. 1975); *Choctaw Gas Company v. Corporation Commission*, 295 P.2d 800 (Okl. 1956). The establishment of priority rules and enforcement of ratable take provisions of Sections 239 and 240 are a reasonable means of protecting correlative rights and preventing waste while regulating the production of natural gas from a common source of supply. Together, these statutes provide a legitimate means for fulfilling the state's objectives in preserving its natural gas reserves and protecting the correlative rights of those with an interest in the reserves.

Findings

1. The regulation of natural gas takes by interstate pipelines is an incident of the exercise of this Commission's jurisdiction over the regulation of the production of natural gas from a common source of supply. The exercise of this incidental jurisdiction is necessary in order to protect correlative rights and prevent waste.

2. Sections 239 and 240 and the regulations promulgated thereunder attempt to accommodate interests of both producer and pipeline by adjusting production of natural gas to demand thereof. The state's interest is furthered by this method by ensuring that production is uniform throughout the common source of supply, protecting against drainage, thus, protecting the correlative rights of all owners of an interest in the natural gas. Any effect such regulation has on interstate commerce is minimal.

3. Commission regulatory jurisdiction over pipeline takes does not encroach upon the jurisdiction of the FERC under the NGA and NGPA. The FERC is not vested with jurisdiction over the production and gathering of gas which is essentially the function of Sections 239 and 240 and the regulations promulgated thereunder.

4. Oklahoma enacted its common carrier and ratable take statutes prior to federal regulation of interstate pipelines. That regulation of natural gas pipelines by the FERC has changed over the years and again is in the process of significantly changing. This Commission's exercise of incidental jurisdiction is not offensive to the proposed federal regulation. *See, generally, Notice of Proposed Rulemaking,* Regulation of Natural Gas Pipelines After Partial Wellhead Decentral, Docket No. RM85-1-000 (Parts A-D) (Issued May 30, 1985). In light of the present regulatory atmosphere this Commission's jurisdiction can co-exist with and complement that of the FERC.

ORDER

The Commission has reviewed the pleading filed in this matter and considered all arguments and makes the following determinations:

1. The Commerce Clause of the United States Constitution does not prohibit the enforcement of 52 O.S. §240 requiring taking of gas against interstate pipelines which are the first purchaser of Oklahoma produced natural gas.

2. The FERC does not have sole authority under the NGA and NGPA over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. §§239 and 240.

3. The pending causes are hereby directed to proceed on their individual merits.

CORPORATION COMMISSION OF OKLAHOMA

JAMES B. TOWNSEND, Chairman

NORMA EAGLETON, Vice-Chairman

HAMP BAKER, Commissioner

DONE AND PERFORMED this 3rd day of July, 1985.
BY ORDER OF THE COMMISSION:

BERDEE S. HOLT, Secretary

EXHIBIT "A"

James A. Payne & Hadsen Petroleum Corp v. Tennessee Gas Pipeline, GC 28066 (Dismissed 4-20-84)

Richland Resources v. Tennessee Gas Pipeline, GS 28063 (Dismissed 11-2-84)

Merrick Inc. v. Panhandle Eastern, CD 105874 (Dismissed 1-14-85)

Petroleum Investments v. Tennessee Gas Pipeline, CD 108687 (Dismissed 9-18-84)

Petroleum Investments v. Southern Natural Gas, CD 109559 (Dismissed 8-15-84)

Petroleum Investments v. El Paso Natural Gas, CD 102788 (Dismissed 7-19-84)

Grace Petroleum v. El Paso Natural Gas, CD 103791

Grace Petroleum v. El Paso Natural Gas, CD 103792

Grace Petroleum v. El Paso Natural Gas, CD 103793

Grace Petroleum v. El Paso Natural Gas, CD 103794

Grace Petroleum v. El Paso Natural Gas, CD 103795

EXHIBIT "B" — APPEARANCES

* John M. Grower, Joseph H. Moss, Jr., John C. Griffin, R. Wilson Montjoy, II, Attorneys, appeared for Southern Natural Gas Company
* Robert J. Middleton, Attorney, appeared for Texas Gas Transmission Corporation
* William J. Legg, Attorney, appeared for ANR Pipeline Company, Colorado Interstate Gas Company, Columbia Gas Transmission Corporation, KN Energy, Inc., Mississippi River Transmission Corp., Natural Gas Pipeline Company of America, Panhandle Eastern Pipeline Company, Tennessee Gas Pipeline Co., Transwestern Pipeline Company, Western Gas Interstate Company
* Steven A. Taube, Lisa A. Machesney, Attorneys, appeared for ANR Pipeline Company
* Jeffrey L. Huntley, William S. Garner, Jr., Attorneys, appeared for Colorado Interstate Gas Company
* Cynthia Wegley Barnett, Giles D. H. Snyder, James P. Holland, Attorneys, appeared for Columbia Gas Transmission Corp.
* William S. Garner, James A. Miller, Attorneys, appeared for KN Energy, Inc.
* Paul E. Goldstein, Priscilla A. Mims, Joseph M. Wells, Jerome Mrowca, James M. Peters, Attorneys, appeared for Natural Gas Pipeline Company of America and Mississippi River Transmission Corp.
* William L. Robertson, Jack Glaves, Attorneys, appeared for Panhandle Eastern Pipeline Company
* F. Nan Wagoner, Stanley L. Cunningham, Laurence M. Huffman, Attorneys, appeared for Tennessee Gas Pipeline Co.
* James W. McCartney, Judy M. Johnson, R. Jeffrey Coppock, Bolivar C. Andrews, Cheryl M. Foley, Attorneys, appeared for Transwestern Pipeline Company
* Phillip G. Lookadoo, Robert A. Rima, James S. D. Eisenhower, III, Robert J. Haggerty, Attorneys, appeared for Western Gas Interstate Company
* Allan DeVore, Marjorie Ramana, Attorneys, appeared for William H. Woods

* Patrick J. McCarthy, Jane G. Alseth, Arnold R. Madigan, Attorneys, appeared for Northern Natural Gas Company
* Thomas S. Jensen, Donald J. MacIver, Jr., James M. Gaitis, Attorneys, appeared for El Paso Natural Gas Company
* James C. T. Hardwick, Kent L. Jones, Paricia L. Dunmire, Attorneys, appeared for Northwest Central Pipeline Corporation
* John L. Arrington, Jr., Curtis M. Long, John A. Gaberino, Jr., David E. Crawford, Attorneys, appeared for Oklahoma Natural Gas
* Leslie Wilson, Attorney, appeared for Oil and Gas Conservation Division, Oklahoma Corporation Commission
* Michael D. Stack, Attorney, and L. O. Ward, appeared for Ward Petroleum Corporation
* Eric E. Anderson, Attorney, appeared for Terry N. Shinn
* Bland Williamson, John L. Randolph, Dennis K. Morgan, Attorneys, appeared for Southern Union Exploration Co.
* Harry C. Marberry, Harry E. Brown, Jr., Attorneys, appeared for Frontier Energy Company
* John L. Randolph, Bland Williamson, Attorneys, appeared for Oklahoma Independent Petroleum Association
* Earnest J. Altgelt, III, Jack P. Fite, Harris S. Wood, Joseph C. Johnson, Attorneys, appeared for Conoco, Inc.
* H. B. Watson, Jr., Richard K. Books, Steve Atcock, Attorneys, appeared for An-Son Corporation, Holden Energy Corporation, H G & G, Inc., Sabine Corporation, Leede Exploration, Williford Energy Company
* Barbara W. Fitkin appeared for Fitkin Petroleum Corporation
* Charles N. Nobles appeared for Bracken Exploration Company

John C. Moricoli, Jr., Attorney, and Loyd Drain appeared for Rosewood Resources (POC), Inc.

John R. Robertson, Jr., Attorney, appeared for PCX Corporation

William D. Tiffee, Ivan Geddie, Attorneys, appeared for Kerr-McGee Corporation

Verland E. Behrens, Attorneys, appeared for Universal Resources Corporation and K. P. Exploration, Inc.

John R. Reeves, Gary L. Paulson, Attorneys, appeared for Amoco Production Company

Hugh D. Rice, Marc R. Pitts, Attorneys, appeared for United Gas Pipe Line Company

Gary R. Baker, III Attorney, appeared for the GHK Company

Bradford G. Keithley, Robert W. Carroll, Laurie Anne Williams, Attorneys, appeared for Agrico Chemical Company

Janet L. Cox, Attorney, appeared for Tag Petroleum, Inc.

Karl F. Hirsch, Mark A. Jones, Attorneys, appeared for Richland Resources Corporation

Donald W. England, Attorney, appearerd for Trigg Drilling Company, Inc.

Richard L. Allen, Attorny, appeared for Donald T. Allen and pro se

J. A. Hannah, Robert W. Baker, Gordon D. Ryan, Attorneys, appeared for Tenneco Oil Company

John C. Buckingham, Attorney, appeared for Fortuna Energy Corporation

Robert A. Hefner, Jr., appeared pro se

Steven A. Moore, Attorney, appeared for Oklahoma Gas and Electric Company

Gary E. Baker, Attorney, appeared for Exxon Corporation

George Dewees Bennett, Attorney, appeared for Union Oil Company of California

Alice S. Mitchell, John Morozuk, Attorneys appeared for Inexo Oil Company

Douglas E. Burns, Attorney, appeared pro se

Robert H. Burnham, Attorney, appeared for Rivondale Oil Company, Inc.

Richard K. Goodwin, Attorney, appeared pro se

Deryl L. Gotcher, Jr., Attorney, and J. W. Loofbourrow appeared for Getty Oil Company

Gerald H. Barnes, Attorney, and R. L. Hocker appeared for Cities Service Oil and Gas Corporation

Galen E. Ward, James Hamilton, Attorneys, appeared for Phillips Petroleum Company

Julian P. Kornfield, Attorney, appeared pro se

Ted Holshouser, Attorney, appeared for William Lane Pennington and Bruce M. Daniel

* Charles B. Davis, Attorney, appeared for Hold Oil Corp.
William D. Curlee, Attorney, and James J. Sweeney appeared for Arkansas Louisiana Gas Company
Paul A. Karns, Attorney, appeared for Transok, Inc.
* David Gustine appeared for Energy Exchange Corporation
* Carl E. Gungoll appeared pro se
* Joe S. Snider appeared pro se
* William D. Harrison appeared pro se
* F. M. Tarpley appeared for Bradley & Tarpley
H. T. Garvin, Jr., Attorney, appeared for Hadson Petroleum Corp., Export Petroleum, Puma Exploration Co.
A. R. Heiman appeared pro se
Kevin P. Claridan appeared for Berexco, Inc.
Jan Young, Oklahoma Senate Staff
David B. Oshel appeared for Bogert Oil Company
G. W. Velotta, II, David O. Cornett, Attorneys, appeared for Mustang Fuel Corp.
Bill Woods appeared pro se
Clifford G. O'Neal appeared pro se
A. E. Martin appeared pro se
Susan Ross, Robert A. Miller, Attorneys, appeared for TXO Production Corp.
Gordon Brown, Attorney, appeared for Woods Petroleum Corp.
Joe Lawter appeared for Farmers Union Coop, Royalty
Rex U. Lollar appeared for Panhandle Royalty Co.
G. A. "Jim" Shirzai appeared for Shirazi & Associates
John Z. Melton appeared pro se
Mary M. Bruehl, Attorney, appeared for Roye Realty
Charles R. Cleveland, Attorney, appeared for Gulf Oil Corporation and Warren Petroleum
Debbie Lessert appeared for Eason Oil Company
Linda Whittington appearred pro se-
David E. Pepper, Attorney, appeared for Towner Petroleum Co.
Guy Taylor, Attorney, appeared for KMI, Inc.
Landon Westbrook, Attorney, appeared pro se
James M. Peters, Attorney, appeared for Grace Petroleum
Mark Withers, Attorney, appeared for Sun Exploration & Production Co.

George Love appeared for Moran Exploration, Inc.
Barth Walker, Attorney, appeared for Petroleum Investments, Ltd.
Ron Frangione, Attorney, appeared for Blue Quail Energy, Inc.
Thomas J. Enis, Attorney, appeared for Gadsco, Inc.
Deborah E. Fortune, Attorney, appeared for Robert Gordon Oil Co.
Richard J. Gore, Attorney, appeared for F. Howard Walsh, Jr.

*Denotes those filing briefs or written comments.

EXHIBIT "C"

*RULE 1-305. *PRIORITY SCHEDULE FOR SUPPLY AND DEMAND IMBALANCE*

(a) Any common purchaser as defined in 52 O.S. 1981, Section 240, shall purchase all the gas which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another, except as authorized by the Commission under (b) below.

(b) In the interest of the prevention of waste and protection of correlative rights, the following priority schedule shall be implemented by any first purchaser of gas whenever the permitted production from all wells in any common source of supply in its system in this state, including gas which is processed, is in excess of that purchaser's reasonable market demand; provided, however, if the first purchaser does not contractually control wellhead production, then the first taker of gas shall be responsible for implement of the following priority schedule.

(i) Priority One – Hardship and distressed wells.

(ii) Priority Two – Enhanced recovery wells.

(iii) Priority Three – Wells producing casinghead gas and associated gas.

(iv) Priority Four – If after the first purchaser or first taker has taken the gas from Priorities One through Three above and still has further market demand in its system for gas, said purchaser or taker shall take ratably from all allocated, special allocated and unallocated common sources which may be offered for sale, and which may reasonably be reached by its trunk lines or gathering lines, without discrimination in favor of one producer as against another or in favor of any one source of supply as against another.

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demand of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratable.

All production from the lower priority wells shall be shut-in before production from any well in the next higher priority is curtailed.

(d) Any well which meets the definition of more than one priority shall be assigned the higher priority.

(e) When there is more than one purchaser or taker involved in the taking of gas from a well into any purchaser's system, all purchasers and takers within that system shall be responsible for compliance with this Rule.

(f) Upon a verified application of the Director of the Oil and Gas Conservation Division, or any other person, the Commission, after notice and hearing, may determine if gas has been ratably purchased or taken from a common source of supply on a systemwide basis in accordance with this rule without avoidable waste and with equitable participation in production and markets by all operators and other interested parties.

(g) In any month wherein a purchaser or taker has a market demand/supply imbalance and must curtail purchases or takes in compliance with this Rule, Form 1004 B shall be filed by said purchaser or taker with the Oil and Gas Conservation Division.

(h) Any interested party may file an application requesting that the Commission, for good cause shown, authorize limited deviation from the general priority schedule provided under (b) above. The Commission on its own motion may initiate a review of the continued need for such a limited deviation. After notice and hearing, the Commission may authorize limited deviation upon finding the that the same is necessary in order to prevent waste, protect correlative rights, or is otherwise required by the public interest or authorized by law.